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IN THE

Supreme Court of the United States

October Term, 1960

Nos.....

SECURITY-FIRST NATIONAL BANK OF LOS ANGELES,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

(17 Cases)

Nos.....

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

(13 Cases)

Nos.....

THE FARMERS AND MERCHANTS NATIONAL BANK OF LOS ANGELES,
Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

(15 Cases)

On Appeal From the Supreme Court of the State of California.

JURISDICTIONAL STATEMENT.

Appellants appeal from the judgments of the Supreme Court of California entered on February 23, 1961, affirming the judgments of the Superior Court of the State of California in and for the County of Sacramento denying recovery in each of forty-five franchise tax refund actions involving identical or closely

related questions.[1] Said appellants submit this joint statement to show that the Supreme Court of the United States has jurisdiction of these appeals and that substantial questions are presented.

Opinions Below.

The opinion of the Supreme Court of California is reported at 55 Adv. Cal. 409. A copy of such opinion is attached commencing at page 1 of the Appendix hereto and a copy of the judgment of said court as entered in the minutes is attached hereto as Appendix page 22. A copy of the unreported opinion of the Superior Court for Sacramento County is attached commencing at Appendix page 23.

Jurisdiction.

These several actions for refund of state franchise taxes were brought under Section 30(b) of the California Bank and Corporation Franchise Tax Act, Cal. Stats. 1929, ch. 13, as amended. The judgments of the Supreme Court of California were entered on February 23, 1961, and notices of appeal in each of said cases were filed in that court on April 5, 1961. The jurisdiction of the Supreme Court of the United States to review the decision below is conferred by Title 28, United States Code, Section 1257(2). The following decisions sustain the jurisdiction of the Supreme Court to review the judgment on direct appeal in this case; *Ohio Bell Telephone Co. v. Public Utilities Commission*, 301 U. S. 292; *Schlesinger v. Wisconsin*, 270 U. S. 230; *Merchants National Bank v. Richmond*, 256 U. S. 635.

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[1]Appellant Security-First National Bank of Los Angeles appeals from the judgments entered in the cases bearing Sac. Nos. 6952-6968, both inclusive, on the files of the California Supreme

Questions Presented.

A California statute provides that the rate of the second installment of the annual California franchise tax on national banks is a percentage equal to the ratio which the California personal property taxes paid by all nonfinancial corporations bears to their California net income. In making the factual determinations necessary to fix the rate—namely, in determining the personal property taxes and net income of non-financial corporations—the California Franchise Tax Commissioner in the years in question relied wholly upon information reported by thousands of such corporations, mainly in their franchise tax returns. Both at the administrative and judicial levels appellant banks were denied the right to inspect or to cross-examine as to this critically important information.

1. In these circumstances, the first question[2] presented is whether the California taxing statute deprived these appellants of their property without due process of law under the Fourteenth Amendment by denying appellants the right to a full and fair hearing and judicial review as to the Commissioner's factual determinations and by thus permitting the Commissioner finally to determine the component factors of the tax rate and the resulting tax liability on the basis of secret

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Court; appellant Bank of America National Trust and Savings Association appeals from the judgments entered in the cases bearing Sac. Nos. 6969-6981, both inclusive, on said files; and appellant The Farmers and Merchants National Bank of Los Angeles appeals from the judgments entered in the cases bearing Sac. Nos. 6982-6996, both inclusive, on said files.

[2]This question is presented in cases bearing (California) Sac. Nos. 6952-6958, 6962-6996.

and unidentifiable evidence without such hearing or review.

2. A second question presented is whether the taxing statute has deprived these appellants of their property without due process of law under the Fourteenth Amendment by preventing them from controverting not only the factual determinations of the Commissioner mentioned above, but also from controverting erroneous factual determinations of California assessing authorities in systematically misclassifying real property as personal property,[3] with the result that the Commissioner in relying upon said determinations erroneously computed the rate and the resulting tax liability upon the basis of an overstated personal property tax component.

3. A third significant and separate question[4] presented is whether the California statute violates the provisions of Section 5219 of the Revised Statutes of the United States [Title 12 United States Code Section 548] by taxing the franchises of national banks at a substantially higher rate and burden than the rate and burden assessed by California upon the franchises of mercantile, manufacturing and business corporations, thus bringing about the unfriendly discrimination in practical operation which it is the purpose of Section 5219 to prevent.

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[3]This question is presented in cases Sac. Nos. 6952, 6955-6958, 6965-6969, 6971-6976, 6979-6982, 6984-6985, 6987, 6992-6996.

[4]This question is presented in all cases.

Statutes Involved.

Sections 1, 4a, 23 and 35 of the California Bank and Corporation Franchise Tax Act,[5] Cal. Stats. 1929, ch. 13, as amended, are set forth commencing at page 31 of the Appendix hereto. Section 5219 of the Revised Statutes of the United States [Title 12 United States Code Section 548] is set forth at page 39 of the Appendix.

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[5]The California Supreme Court noted in its opinion as follows:

> "The act has been codified in the Revenue and Taxation Code as Section 23001 et seq., effective July 1, 1951. The cases relate to a period prior to the codification, and, as has been done by the parties, reference will be made to sections of the act rather than to the code. (Appendix, p. 2, n.)

Appellants will follow the same procedure here.

Statement.

California's present method of taxing national banks was adopted in 1933 by the enactment of the above-mentioned Section 4a of the Bank and Corporation Franchise Tax Act. The tax is a franchise tax, assessed annually, according to or measured by net income from all sources; it is payable in two installments.

The first installment requires national banks to pay at the same flat percentage rate as that applicable to non-financial corporations, whose franchises are also taxed under the Act.

The second installment requires the banks to pay at an excess rate over and above that applicable to the non-financial corporations. This excess rate is determined by the application of a formula. And it is this second phase—the Section 4a formula method—which is under attack in these cases.

This excess rate applied as to national banks[6] equals, in theory, the percentage of the California net income of non-financial corporations required to be paid as California personal property taxes.

The operation of the Section 4a formula called for the then Franchise Tax Commissioner to make two factual determinations annually. These were (1) the California net income, if any, of every non-financial corporation taxable under the Act; and (2) the California personal property taxes, if any, required to be paid by every such corporation. This was a sizeable task;

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[6]In attempted compliance with Section 5219 of the Revised Statutes [12 U.S.C. § 548], California also applies the excess rate to state banks and to financial corporations generally.

in 1949, for example, there were 30,000 such corporations.

The evidence upon which the Commissioner acted in making these twin determinations was obtained, without significant exception, from the non-financial taxpayers. This evidence consisted mainly of the franchise tax returns filed by the latter, plus, in a comparatively limited number of cases, certain supplementary information also reported by such taxpayers.

The Secrecy Issue. It is at this point that the secrecy provisions of Section 35 of the Act become material. That section provides, with exceptions not here applicable, that it is a misdemeanor to reveal the business affairs of a franchise taxpayer.

As interpreted and applied by California at both the administrative and the judicial levels, Section 35 bars disclosure as to any factual information[7] reported on the return as related to any identifiable taxpayer. As to any given non-financial taxpayer, the practical result was disclosure of identity but secrecy as to information reported on the one hand, and disclosure of information reported but secrecy as to identity, on the other.

This was the course followed through all of the annual rate hearings at which, according to Section 4a, the bank taxpayers were to be given an opportunity to

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[7]Such as gross income, deductions therefrom, net income, allocation of net income as between California and other taxing jurisdictions, personal property taxes required to be paid and the identity of the taxing entity levying such taxes.

examine the "data"[8] gathered by the Commissioner for bank tax rate purposes.

Appellants paid their taxes at the determined rate and sued for refund as permitted by the statute. Act, §§ 4a, 30(b). They were denied inspection of the returns at the discovery stage of the several actions. See *Franchise Tax Board v. Superior Court*, 36 Cal. 2d 538.

At trial, the same procedure was followed: Access to the returns was denied. The trial court so applied Section 35 as to sustain a tax liability upon these appellants based upon secret evidence—the non-financial returns and reported information supplemental thereto —which neither the trial court nor these appellants ever saw. The returns and other material, lying undisclosed in the possession of appellee, were offered by appellants and excluded from evidence. [17 Rep. Tr. 4561,[9] 4613, 4616, 4624-4625, 4627.] The right of appellants to inspect and examine the returns in the possession of the Commissioner was denied [17 Rep. Tr. 4562, 4621, 4624, 4627; 23 Rep. Tr. 6245-6249] as was the right to cross-examine as to their contents

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[8]According to the California Supreme Court, the "data" in question relates to anonymous statistics compiled by the Commissioner from the returns, not the returns themselves. *Franchise Tax Board v. Superior Court*, 36 Cal. 2d 538, 547-548.

[9]Denoting Volume 17, page 4561 of the Reporter's Transcript of the consolidated trial of these cases. Other such citations will be similarly abbreviated.

[17 Rep. Tr. 4542, 4553, 4558, 4560-4561, 4621, 4627.] Offers of proof after objections sustained and requests that returns be marked for identification as evidence of such offers of proof were denied [17 Rep. Tr. 4562-4664, 4627-4632, 4635] and, to cap the climax, motions of appellants that the *court* be permitted to inspect the returns were also denied. [17 Rep. Tr. 4562, 4614, 4621.]

Ultimately, judgment was entered in each of the cases upholding the excess rate and tax. The state Supreme Court affirmed. As a result, the Commissioner's determinations of fact affecting vested rights of these taxpayers were upheld without either of the reviewing courts even seeing the evidence upon which the administrative officer acted. And these taxpayers were likewise denied the right to controvert the assumptions of fact made by the Commissioner upon the basis of undisclosed evidence reported by the non-financial taxpayers.

The Misclassification Issue. Under the holding of the State Supreme Court in this case, these appellant taxpayers were also denied the right to controvert the factual determinations of California assessing authorities with reference to the classification of taxable property as being realty or personalty. The Commissioner relied upon these determinations, as reported by the non-financial taxpayers in their returns, and utilized them in arriving at his own determinations as to the personal property tax factor of the Section 4a formula.

[2 Rep. Tr. 237, 243, 367, 431; 3 Rep. Tr. 618; 4 Rep. Tr. 751, 756, 896-7; 5 Rep. Tr. 1193.] At all of the rate hearings, he refused to hear evidence showing the reporting by non-financial taxpayers, as *personal property* taxes, of taxes actually paid on misclassified *real* property,[10] with resultant upward distortion of the personal property tax component of the rate computations.

At trial, appellants proved and the trial court found[11] widespread misclassification by *ad valorem* assessing authorities of trade fixtures, including heavy, affixed machinery, as personal property;[12] that such misclassification had been reflected in and resulted in an appreciable[13] increase in the rate and second installment of tax for the particular years involved.

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[10]Finding 8(b)(2) in each of the cases specified, *supra*, in footnote 3; *e.g.*, Sac. No. 6952, Clk. Tr. (Clerk's Transcript) 187-188. Other such citations will be similarly abbreviated. Also, since all findings bearing a given number are identical *in form* in each case where such a numbered finding was made and since the Clerk's Transcript in Sac. No. 6952 contains all findings material to the questions raised on these appeals, that transcript will be used as a standard citation to all findings referred to in the text.

[11]Finding 16; *e.g.*, Sac. No. 6952, Clk. Tr. 195.

[12]Such installations are *real* property under California law. Cal. Rev. and Tax. Code §§ 104-106. And taxes paid as real property taxes have no place in the Section 4a rate computations.

[13]As to the matter of "appreciable" increase, the trial court also found [Finding 17, *e.g.*, Sac. No. 6952, Clk. Tr. 196] that at no time did the Commissioner or his successor, the appellee Board, keep or maintain any records which would enable either the plaintiffs (appellants) to prove or the court to find, *the extent to which either the formula rate or the second installment of tax was increased by reason of the misclassification found to exist.*

Upon appeal the California Supreme Court held, as to this phase of the matter, that the classification determinations, right or wrong, of the assessing authorities as reported to and utilized by the Commissioner, were *conclusive* as against these taxpayer appellants, notwithstanding any increase in the rate by reason of the proven misclassification. Opinion below, Appendix hereto, page 18.

The Issue Under Section 5219 of the Revised Statutes.[14] Wholly aside from the manner of its administration of the Section 4a formula, California's application of an excess rate to national banks appears on the face of the statute. Its reason for so doing is its desire to circumvent the congressionally granted immunity of the personal property of such banks from taxation by the states. R. S. 5219; *Cf. M'Culloch v. Maryland*, 4 Wheat. 316. Thus, the California State Board of Equalization correctly characterizes the second installment of tax produced by the excess rate as being "the 'personal property tax equivalent' now exacted from banks . . . to make up for their exemption from personal property tax." [12 Rep. Tr. 3005.]

It is implicit in the holding of the California Supreme Court that a state may, consistently with R. S. 5219, overtax a given taxable subject in the hands of national banks as a result of its inability, under that very statute, to reach another. Appendix, pp. 3-9.

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[14]Hereinafter referred to as R. S. 5219.

How the Federal Questions Are Presented.

The questions presented by these appeals were raised in and were passed upon by the trial court and the California Supreme Court.

The record shows that appellants raised[15] and that the trial court passed upon[16] the question of whether the determination of appellants' tax rate on the basis of secret and incontrovertible evidence violates the due process clause of the Fourteenth Amendment. The repugnancy of the Act, as applied, to the due process clause was raised in detail in all of the subject cases at the time of the trial court's exclusionary rulings as to the secret evidence [17 Rep. Tr. 4547-4552, 4624, 4584-4587]; at the close of plaintiffs' (appellants') case [18 Rep. Tr. 4797-4803]; and at the conclusion of the trial [Rep. Tr. 6350-6351.] In addition to this, the repugnancy of the statute to the due process

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[15]A typical framing of the question appears in the following statement of counsel for appellants at the trial:

> ". . . we explicitly and respectfully reiterate and insist that the California Bank and Corporation Franchise Tax Act, and each and every section thereof, and the California Bank and Corporation tax law and each and every section thereof as applied to these plaintiffs and each of them is and are repugnant to and violative of, first, the due process of law clause of the Fourteenth Amendment to the Constitution of the United States. . . ."

17 Rep. Tr. 4624. See, also, 17 Rep. Tr. 4546-4552, 4584-4587; 18 Rep. Tr. 4797-4803; 23 Rep. Tr. 6350-6351.

[16]17 Rep. Tr. 4542, 4553, 4558, 4560, 4561, 4562-4564, 4613, 4614, 4616, 4621, 4624, 4625, 4627-4632, 4635; 23 Rep. Tr. 6245-6249; see, also, judgment in each case denying recovery at trial level, *e.g.*, Sac. No. 6952, Clk. Tr. 203.

clause was also raised in the claim for refund annexed as an exhibit to the complaint in each of the cases tendering the issue of misclassification by assessing authorities.[17]

The claims for refund annexed to the complaint in each case raised the question of conflict between the state taxing statute and R. S. 5219.[18]

The question was also raised at the trial by appellants [see, *e.g.*, 23 Rep. Tr. 6350-6351], and the trial court decided this issue in its findings, conclusions of law and judgment in each case.[19]

Under California practice, a general appeal to the state Supreme Court raises for its consideration every error of the trial court revealed by the record; there is no procedure for a formal designation or assignment of

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[17](Sac. No.) 6952 [Clk. Tr.] 17-18; 6955, 23; 6956, 43; 6957, 25, 29; 6958, 24, 29; 6965, 23, 28; 6966, 22, 26; 6967, 28, 32; 6968, 22, 26; 6969, 192; 6971, 27, 28-30; 6972, 47-48; 6973, 68-69; 6974, 70-71; 6975, 74-75; 6976, 55-56; 6979, 75-76; 6980, 74-75; 6981, 78-79; 6982, 15; 6984, 18; 6985, 17; 6987, 13, 18; 6992, 14, 19; 6993, 14, 19; 6994, 13, 18; 6995, 15-16; 6996, 15, 20.

[18](Sac. No.) 6952, [Clk. Tr.] 11, 12; 6953, 11; 6954, 18-20; 6955, 17-18; 6956, 36-37; 6957, 16-17; 6958, 16-17; 6959, 19; 6960, 11; 6961, 15; 6962, 12; 6963, 10-11; 6964, 11; 6965, 15-16; 6966, 14-15, 16; 6967, 18-19; 6968, 14, 16-17; 6969, 197; 6970, 16-17; 6971, 24, 35; 6972, 52; 6973, 73; 6974, 75-76; 6975, 79-80; 6976, 60; 6977, 17-18; 6978, 21; 6979, 80; 6981, 83; 6982, 11; 6983, 9-10; 6984, 12; 6985, 11; 6986, 10; 6987, 8, 9, 21; 6988, 10-11; 6989, 10; 6990, 10; 6991, 14; 6992, 9-10; 6993, 9-10; 6994, 9, 20; 6995, 10, 23; 6996, 10-11, 23-24.

[19]Findings 18, 19, 20, conclusions of law and judgment in all cases, *e.g.*, Sac. No. 6952, 196-197, 202, 203.

errors in the appeal papers. California Rules on Appeal, Rules 1, 4(a), 5(a), 13, 15(a). Appellants followed this procedure here; they designated a full record on the California appeal [see, *e.g.*, Sac. No. 6952, Clk. Tr. 204, 205] and raised the questions here presented in their briefs to the state Supreme Court. Copies of all briefs on the state appeal have been certified and lodged so that the Court may see the manner in which the federal questions were raised on the appeal.[20] The decision of the California Supreme Court, affirming the trial court, passed upon these contentions.[21]

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[20]The due process questions are raised at pp. 34-55, 77 of Appellants' Opening Brief and again at pp. 7-43 of Appellants' Closing Brief. The § 5219 question is raised at pp. 56-77, 91-112 of Appellants' Opening Brief and again at pp. 44-67 of Appellants' Closing Brief.

[21]The due process questions are considered and decided at pp. 10-18 of the Opinion as set forth in the Appendix hereto. The § 5219 question is considered and decided at pp. 3-9 of the Opinion as so set forth.

THE QUESTIONS ARE SUBSTANTIAL.

I.

The Application of the California Franchise Tax Act to Appellants Violates the Due Process Clause of the Fourteenth Amendment.

The California Supreme Court upholds the Franchise Tax Commissioner's power to determine appellants' tax rate upon the basis of secret evidence which appellants were not permitted to examine, to controvert, or to test by judicial review. In addition, that court approves the determination of appellants' tax rate upon assumptions of fact which appellants were not permitted to controvert. The result, as we shall show, is a striking denial of due process.

A. The Use of Secret Evidence.

The fundamental principle for which appellants contend in these cases is that upheld by this Court in another case in the quasi-legislative field which condemned the use of secret evidence. The case is *Ohio Bell Telephone Co. v. Public Utilities Commission,* 301 U. S. 292, and the principle is that of protection of the individual against arbitrary action through the "inexorable safeguard of a fair and open hearing." 301 U. S. at p. 304; *cf. St. Joseph Stockyards Co. v. United States,* 298 U. S. 38, 73; *Morgan v. United States,* 298 U. S. 468, 480, 481; *Interstate Commerce Com. v. Louisville & Nashville R. Co.,* 227 U. S. 88, 91.

Here, as in *Ohio Bell,* what the trial and appellate courts in California did, per the offending statute, "was

to take the word of the [Commissioner] as to the outcome of a secret investigation, and let it go at that." 301 U. S. at p. 304. Here, as there, "This will never do if hearings and appeals are to be more than empty forms." 301 U. S. at p. 303. "From the standpoint of due process—the protection of the individual against arbitrary action—a deeper vice is this, that even now we do not know the particular or evidentiary facts" upon which the Commissioner rested his action. 301 U. S. at p. 302.

Where, as here, a taxing statute calls for factual determinations by an administrative board or officer, the taxpayer is entitled to a hearing—a full and fair hearing—at *some* stage of the proceeding before the tax becomes irrevocably fixed. *Londoner v. Denver,* 201 U. S. 373, 385, 386; *cf. Bull v. United States,* 295 U. S. 247, 259; *Hagar v. Reclamation Dist.,* 111 U. S. 708, 709, 710. This is one of "the rudiments of fair play" assured to every litigant by the Fourteenth Amendment as a "minimal requirement." *Ohio Bell Telephone Co. v. Public Utilities Com., supra,* 301 U. S. 292 at 304-305.

The California Supreme Court, in holding that a hearing was not required, justifies its interpretation of the Act upon three principal grounds.

The court below first asserts that there is no constitutional requirement for a full and fair hearing either in a quasi-legislative proceeding or on judicial review of administrative factual determinations underlying the fixing of a tax liability, where such a hearing was denied at the administrative level. *Bi-Metallic Investment Co. v. Colorado State Board of Equalization,* 239 U. S. 441, is cited by the California Supreme Court in support

of its view in this regard. But *Bi-Metallic* is no authority at all for the proposition that a taxpayer, in the circumstances here present, is not entitled to a full and fair hearing at the judicial level where such a hearing has been denied at the administrative stage.[22] *Cf. Ohio Bell Telephone Co. v. Public Utilities Com., supra,* 301 U. S. 292 and the cases cited above to the proposition that a taxpayer is entitled to a hearing at some stage before the tax is irrevocably fixed.[23]

In negating the right to a hearing at some stage, the California Supreme Court also relies upon its earlier decision in *Franchise Tax Board v. Superior Court,* 36 Cal. 2d 538, in which it was held that these appellants were not entitled to inspection, *prior to trial,* of the returns and other secret material underlying the rate computations for the year 1943. [Sac. Nos. 6952, 6969, 6982.] That decision did not, however, as do the decision and judgments here appealed from, uphold both the secrecy *and* the tax after trial on the merits. Hence California had not, at that intermediate stage, denied to appellants the right to a full and fair hearing *at all stages of the tax proceeding,* including trial or review. That could only take place when at trial, both the secrecy and the tax were upheld and the judgments of the trial court denying refund of the taxes were

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[22]It is also worthy of note that in *Bi-Metallic* the taxpayers had already had, at the local level, the hearing as to comparative valuations to which they were constitutionally entitled under *ad valorem* procedures. 239 U. S. at p. 444.

[23]See also, in this regard, *Ohio Valley Co. v. Ben Avon Borough,* 253 U. S. 287, where both the majority and the dissenting opinions agreed on the necessity for some type of judicial scrutiny of the evidence underlying a quasi-legislative determination.

affirmed by the highest court of the state. Then and then only were the respective tax liabilities of the appellants irrevocably fixed, so far as California is concerned. The result is that while the *Franchise Tax Board* decision upheld the secrecy, at an intermediate level, the judgments below finally upheld both the secrecy *and the tax;* and it is this application of the Act, as to each of the cases below, which operates to deprive appellants of their property without due process of law.

The second ground relied upon by the California Supreme Court concerns various and sundry offers by appellee at trial to furnish such "information" as would not transgress the prohibitions of Section 35. The undisputed testimony was that the Commissioner's "determinations" could not have been verified by any of the methods suggested by appelleee. [22 Rep. Tr. 5914.]

None of these offers were such as to connect up any given non-financial corporation with the net income (or loss) or the components thereof reported by such corporation. Without this information, the plain fact remains that there was no possible way of proving or disproving whether *any* of the figures, net income or personal property tax, included by the Commissioner in his rate computations, were properly so included. This is so for the reason that the question as to whether either the net income figure or the personal property tax figure reported by any given non-financial corporation should be utilized in the Section 4a rate computations depends *entirely* upon its status as being either a net income or a net loss corporation.

According to Section 4a, if a given corporation reports net income, both its net income and its reported personal property taxes are to be used in the formula computations. If it reports a net loss, only the excess, if any, of its personal property taxes over its net loss is to be used. (In 1949, for instance, there were some 9800 corporations which filed net loss returns.) If, on the other hand, the corporation's reported net loss exceeded its personal property taxes (and this was generally the case) its figures were not to be employed in the computations at all.

Since, as the California Supreme Court holds, Section 35 requires that all access to the net income, or components thereof, of identifiable taxpayers be denied (as it was), the bank taxpayers are wholly at the mercy of the taxing authorities' say-so as to whether *any* of the figures utilized were properly included in the rate computations. And this is of course true as to every corporation filing a return for every year here involved.

The California Supreme Court's third justification for its holding as to the secrecy lies in its attempt to liken the present situation to the "common" one wherein proof of alleged facts is merely rendered more difficult because of the existence of a privilege bar. The California court's thesis in this regard, as in others, will not bear close scrutiny. The present is clearly *not* a situation where a privilege bar merely makes it more difficult for a party to prove his case.

Here the State of California has done everything in its power to prevent any judicial review whatever

as to the correctness of the Commissioner's factual determinations. It has first provided that the excess rate shall be determined from the secret evidence: the sole evidence upon which it is based. The legislature has then provided that neither the state nor the taxpayer may exhibit, examine or prove the contents of the returns in court. In any litigation concerning the correctness of the rate the state itself may not prove it right nor will it permit the taxpayer to prove it wrong. And the secrecy extends even to secondary evidence—retained copies of the returns.[24] *Cf. Webb v. Standard Oil Co.*, 49 Cal. 2d 509.

In these circumstances, California's refusal to unveil the sole evidence underlying the Commissioner's determinations, while at the same time upholding the tax,

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[24]The plain fact is that the returns were suspect from the beginning. At one of the rate hearings it was admitted that the non-financial taxpayers were negligent in reporting their personal property taxes. [13 Rep. Tr. 510, 514.] Distortions in the rate, adverse to the banks, resulted from erroneous classifications by assessing authorities which were held to be conclusive as to these appellants. From 1937 on, over 80%, and in some years over 90% of the non-financial returns had not been audited at the time of the bank rate "determinations." [Finding 10, *e.g.*, Sac. No. 6952, Clk. Tr. 190.] This meant, for instance, that deductions claimed by the non-financial taxpayers were allowed in most cases without question, insofar as the banks were concerned. As a result, a test recomputation of the net income factor for past years, made by appellee's staff as of December 31, 1951, showed for every year here involved but one, that the net income factor had been understated, for bank tax purposes, by many millions of dollars. [17 Rep. Tr. 4689.]

transcends any mere question of privilege and becomes one of depriving these taxpayers of their property without due process of law.

B. The Imposition of Tax Liability Predicated Upon Incontrovertible Assumptions of Fact.

It is well settled that a statute which imposes a tax upon assumptions of fact which the taxpayer is forbidden to controvert is so arbitrary and oppressive that it cannot stand under the due process clause of either the Fifth or Fourteenth Amendments. *Heiner v. Donnan,* 285 U. S. 313; *Schlesinger v. Wisconsin,* 270 U. S. 230.

The Act violates this principle in two respects. By reason of the secrecy provisions already discussed, the taxpayer is forbidden to controvert the factual assumptions or determinations of the Commissioner as to individual and aggregate net income and personal property tax figures reported by the non-financial taxpayers. Also, as interpreted by the California Supreme Court, the Act forbids the taxpayer to controvert the factual assumptions of *ad valorem* assessing authorities, relied upon by the Commissioner, as to whether taxes reported as having been paid by the non-financials were in fact levied upon personal, as distinguished from misclassified real property.

The Commissioner at all rate hearings refused to receive evidence as to misclassification. At trial, the court permitted such proof and found widespread mis-

classification by assessing authorities which was reflected in and caused an appreciable increase, in an amount not determinable by the Commissioner's or the appellee's records, of the bank tax rate.[25] The California Supreme Court, on appeal, upheld the Commissioner's position and ruled that the classification determinations of the assessing authorities were intended by the legislature to be conclusive for bank tax rate purposes.

As a result, the Act as applied in these cases imposes a tax upon the assumption that the assessors' determinations were in all cases correct, when the contrary was both proved and found at the trial, to the prejudice of these taxpayers. In these circumstances, the Act, since it imposes a tax upon the basis of assumptions of fact which these taxpayers were forbidden to controvert, is repugnant to the due process clause.

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[25]The misclassification under discussion redounded to the disadvantage of the banks but not to that of the non-financial taxpayers. California taxes real and personal property at the same *ad valorem* rate for each taxing district. *Simms v. Los Angeles County*, 35 Cal. 2d 303, 311. Some taxing districts, however, levy only as against real property. *Ibid.*, 35 Cal. 2d at p. 315. Misclassification of real property as personalty therefore does not disadvantage the non-financial corporations in any case, whereas it advantages them to the extent that they thereby escape taxes levied by real property taxing districts. The burden of such misclassification thus falls solely upon the banks through increase of the personal property tax factor of the Section 4a formula.

II.

The California Taxing Statute Violates R. S. 5219.

In addition to the shortcomings of the California statute from the standpoint of due process, the Act on its face provides that the franchises of national banks shall be subjected to a rate and burden up to not less than twice that imposed upon the franchises of non-financial corporations. This situation presents a clear case of unlawful discrimination against a federal instrumentality, within the prohibitions of R. S. 5219.

The importance of national banks as federal instrumentalities was pointed out in *Franklin National Bank v. New York*, 347 U. S. 373, 375, where the Court said:

> ". . . The United States has set up a system of national banks as federal instrumentalities to perform various functions such as providing circulating medium and government credit as well as financing commerce and acting as private depositaries. . . ."

And in *First National Bank v. Anderson*, 269 U. S. 341, 347:

> "National banks are not merely private moneyed institutions but agencies of the United States created under its laws to promote its fiscal policies; and hence the banks, their property and their shares cannot be taxed under state authority except as Congress consents and then only in conformity with the restrictions attached to its consent."

R. S. 5219 is the exclusive vehicle whereby congressional consent to state taxation of national banks has been manifested. It provides that in the case of a tax according to or measured by net income of a na-

tional banking association from all sources, *i.e.*, a tax of the type adopted in California, "the rate shall not be higher . . . than the highest of the rates assessed by the taxing state upon mercantile, manufacturing and business corporations doing business within its limits. . . ." These latter corporations are the non-financial corporations elsewhere referred to herein.

Despite this manifestation of the congressional intent, the franchises of national banks were taxed by California at three times the uniform or flat rate applied to non-financial corporations during the years 1933-1934; they were taxed at twice such rate during 1935-1941; and during the years 1942-1949 they were taxed at rates varying from 5.99% to 7.89% as compared with the 4% flat rate applied to non-financial corporations.[26]

In deciding that the California taxing statute does not, in these circumstances, violate R. S. 5219 the Supreme Court of California relied principally upon *Tradesmens National Bank v. Oklahoma Tax Commission*, 309 U. S. 560, the only case decided by the Court with reference to the franchise tax method of taxation permitted by R. S. 5219 since 1926.[27] The true ra-

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[26]In these latter years only, 1942-1949, the rate as computed did not reach or exceed the ceiling rate prescribed by Section 4a for the banks: 6% for 1933-1934 and 8% thereafter, as compared with 2% and 4%, respectively, as applied to the non-financial corporations.

[27]In *Tradesmens* Oklahoma, as does California, taxed the franchises of national banks according to or measured by their net income from all sources, including tax exempt income. However, Oklahoma taxed the franchises of its non-financial corporations by an *ad valorem* tax, and in addition thereto, taxed such corporations by a conventional net income tax which excluded tax exempt income. The rate of such income tax was the same as that assessed under the bank franchise tax; but the tax exempt income of the banks was included in the measure of the

tionale of the *Tradesmens* case is that where, agreeably with R. S. 5219, a state reaches the tax-exempt income of national banks under one type of franchise tax, it is competent for it to reach the tax exempts of "mercantile, manufacturing and business" corporations under another, always provided that discrimination against the banks is not shown. *Cf. Davenport Bank v. Davenport Board of Equalization*, 123 U. S. 83, 85.

Unlike Oklahoma, California conforms its method of taxing non-financial corporations precisely to the franchise tax method expressly permitted by R. S. 5219 in the case of national banks. Thus, in California, unlike Oklahoma, the subject (the franchise)[28] and the measure of the tax (net income from all sources) are identical in the case of both the banks and the non-financials. *Only the rate is different.* And it is this difference in rate in these circumstances which not only effectually distinguishes the situation in *Tradesmens* from the situation here, but renders the California statute discriminatory on its face. *Merchants*

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bank franchise tax, while the tax exempt income of the non-financial corporations was not included in the measure of the income tax. It was for these reasons, *i.e.*, because of the differences in the *subject* and *measure* of the respective taxes, that the Court made its comparison to show that if the tax exempt income of the non-financial corporations had been included in the measure of a hypothetical *6%* franchise tax, practically all of the Oklahoma non-financial corporations would have paid less than they actually had paid under the *ad valorem* method of taxing their franchises. If the *subject* and *measure* of the tax had been, as here, the same for both banks and non-financial corporations, the question of discrimination could have been determined from the face of the taxing statutes. *Cf. Merchants National Bank v. Richmond*, 256 U. S. 635.

[28]A tax under the so-called fourth method permitted by R. S. 5219 is a franchise tax. *Tradesmens National Bank v. Oklahoma Tax Com., supra*, 309 U. S. 560.

National Bank v. Richmond, 256 U. S. 635; *First National Bank v. Anderson, supra*, 269 U. S. 341; *Minnesota v. Bank of St. Paul*, 273 U. S. 561.[29]

California candidly admits that it overtaxes the franchises of the banks in order "to make up for their exemption from personal property tax." [12 Rep. Tr. 3065.] It therefore admits, with equal candor, that it increases the burden on the banks' taxable property—their franchises—because they own some that is free. This California may not do. *Cf. National Life Ins. Co. v. United States*, 277 U. S. 508, 519. So, also, viewed either as an indirect attempt to reach the exempt personal property or as a direct attempt to circumvent the congressional immunity itself, the tax is bad as violating the principles laid down in *Miller v. Milwaukee*, 272 U. S. 713, 715, and in *Frick v. Pennsylvania*, 268 U. S. 473, 494.

The question turns, of course, on the intention of Congress when it enacted the 1926 amendment to R. S. 5219 which brought the so-called fourth method of taxing national banks into being. We have set forth, commencing at page 42 of the Appendix hereto, pertinent discussions in Congress leading up to the 1926 amendment. They show beyond a doubt that the fourth

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[29]In the Court's recent decision in the share tax case of *Michigan National Bank v. Michigan*, ... U. S. ....., 29 Law Wk. 4252, while the differential in rates appeared on the face of the taxing statutes, the disparity in rate was held to be justified by reason of the fact that the bank's deposits were not taken into consideration, a matter which the Court felt essential to any realistic evaluation of the shares from the standpoint of possible discrimination under R. S. 5219. There is no such justification for California's higher rate. An excise tax measured by net income, such as that imposed by California, necessarily includes in the measure of the tax the net income produced by the bank deposits in the course of the bank's operations.

method was adopted solely for the purpose of permitting the states to tax the franchises of national banks to the same extent and in the same manner as a number of states were then taxing the franchises of non-financial corporations, *i.e.*, according to or measured by their net income from all sources.

Congress was willing, in other words, to permit the ordinarily tax exempt income of the banks to be reached indirectly by a franchise tax to the same extent as the states were already reaching such income in the hands of non-financial corporations generally. But this is all that it did permit. Neither the history of R. S. 5219 nor the decisions of the Court interpreting that section afford any support for a taxing scheme, such as California's, which exceeds the congressional consent by systematically discriminating against a given taxable subject in the hands of the national banks.

One significant result of California's synthetically devised rate structure is clear. By virtue of the 1926 amendment California may lawfully reach the tax-exempt income of the national banks by including it in the measure of its franchise tax. But what California does in addition to merely reaching such income, is to tax it at up to twice the rate and burden imposed upon tax-exempt income in the hands of the non-financial corporations. It is common knowledge, of which the Court may take judicial cognizance, that national banks hold far and away more tax exempt securities than any other class of taxpayers in any state.[30] And they

[30]Compare Finding 21 in each case, *e.g.*, Sac. No. 6952, Clk. Tr. 197, with the stipulated facts in the *Tradesmens* case: . . . "only thirty-seven of these six thousand [non-financial] corporations owned government bonds. . . ." 309 U. S. at p. 568.

hold them in aid and furtherance of the fiscal policies of the government of the United States.

For the reasons given, it is respectfully urged that the California method of taxing national banks is in violation of R. S. 5219.

Conclusion.

It is submitted that the questions presented by these appeals are substantial and of public importance; and that probable jurisdiction should be noted.

Respectfully submitted,

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APPENDIX.

Opinion of the California Supreme Court.

[Sac. Nos. 6952-6968. In Bank. Feb. 23, 1961.]

Security-First National Bank of Los Angeles (a National Banking Association), Appellant, v. Franchise Tax Board of the State of California, Respondent.

[17 Cases]

[Sac. Nos. 6969-6981. In Bank. Feb. 23, 1961.]

Bank of America National Trust and Savings Association (a National Banking Association), Appellant, v. Franchise Tax Board of the State of California, Respondent.

[13 Cases]

[Sac. Nos. 6982-6996. In Bank. Feb. 23, 1961.]

The Farmers and Merchants National Bank of Los Angeles (a National Banking Association), Appellant, v. Franchise Tax Board of the State of California, Respondent.

[15 Cases]

Appeal from judgments of the Superior Court of Sacramento County. C. A. Paulsen, Judge.* Affirmed.

Actions by national banking associations to recover taxes imposed under the Bank and Corporation Franchise Tax Act. Judgments for defendant affirmed.

O'Melveny & Myers, Pierce Works, Howard J. Deards, Lawler, Felix & Hall, Brenton L. Metzler, Sam-

*Assigned by Chairman of Judicial Council.

uel B. Stewart, Jr., and Hugo A. Steinmeyer for Appellants.

Stanley Mosk, Attorney General, James E. Sabine and Irving H. Perluss, Assistant Attorneys General, Ernest P. Goodman, Deputy Attorney General, and Felix S. Wahrhaftig for Respondent.

Gibson, *C. J.*—Plaintiffs, national banking associations, appeal from judgments denying recovery in actions for the refund of taxes imposed under the Bank and Corporation Franchise Tax Act during the years 1933 through 1949. (Stats. 1929, ch. 13, p. 19, as amended; Deering's Gen Laws, 1944, Act 8488.)[1]

From 1935 through 1949 subdivision 3 of section 4 of the act imposed a franchise tax at the flat rate of 4 per cent of net income upon every corporation except financial corporations and those exempted by the Constitution or the act. The corporations taxable under this provision (hereafter referred to as nonfinancial corporations) were required to pay, in addition, other taxes including personal and real property taxes. Banks and other financial institutions were required to pay as a franchise tax a percentage of net income, not to exceed 8 per cent, made up of two parts: (1) a flat rate of 4 per cent, as paid by nonfinancial corporations.

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[1]The cases before us, totaling 45, include separate actions by each of the three plaintiffs for each of the taxable years, except that there are no actions for Farmers and Merchants Bank for 1933 and 1934 or for Bank of America for 1933-1935 and 1939. The actions were consolidated for trial.

The act has been codified in the Revenue and Taxation Code as section 23001 et seq., effective July 1, 1951. The cases relate to a period prior to the codification, and, as has been done by the parties, references will be made to sections of the act rather than to the code.

and (2) an additional percentage determined on the basis of the ratio between the total personal property taxes required to be paid by nonfinancial corporations and their total net incomes attributable to California. (§4a.) In 1933 and 1934 section 4a provided that the flat rate, like the one then applicable to nonfinancial corporations, was 2 per cent (rather than 4 per cent) and that the combination of the flat rate and additional percentage should not exceed 6 per cent.[2] The act provides that the tax on the franchise of banks is in lieu of all other state, county, or municipal taxes or licenses except real property taxes (§3.) There is no such provision with respect to other corporations.

National banks, such as plaintiffs, may be taxed by a state only as expressly permitted by Congress. (Iowa-Des Moines Nat. Bank v. Bennett, 284 U. S. 239, 244 [52 S. Ct. 133, 76 L. Ed. 265]; First Nat. Bank v. Anderson, 269 U. S. 341, 347 [46 S. Ct. 135, 70 L. Ed. 295].) Section 5219 of the Revised Statutes of the United States (12 U. S. C. §548) sets forth the four methods by which a state may tax those banks. The fourth method, which has been adopted by California, is to tax them "according to or measured by their net income." When this method is used, the "entire net income received from all sources" may be in-

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[2]None of the various other amendments to section 4a between 1933 and 1949 need be mentioned here. The material provisions appear in the section as it read in 1949: "The rate of tax on National banking associations and other banks and financial corporations mentioned in Sections 1, 2, and 4 of this act, shall be a percentage equal to the percentage of the total amount of net income, allocable to this State, of every corporation taxable under subdivision (3) of Section 4 of this act, other than public utilities as defined in the Public Utilities Act, for the next preceding calendar year or fiscal years ended during such calendar year,

cluded, but the rate shall not be higher than the rate assessed upon other financial corporations "nor higher than the highest of the rates assessed by the taxing state upon mercantile, manufacturing, and business corporations doing business within its limits." It is set-

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required to be paid to this State as franchise taxes according to or measured by such net income, and required to be paid to this State or its political subdivisions by such corporations as personal property taxes during the preceding calendar year or fiscal years ended in such calendar year; provided, however, that said rate of tax shall not exceed 8 percentum. The percentage of the net income of every corporation taxable under subdivision (3) of Section 4 of this act, other than public utilities as defined in the Public Utilities Act, required to be paid to this State or its political subdivisions in personal property taxes shall be determined by ascertaining the ratio which the total amount of such personal property taxes, less 4 percentum thereof, bears to the total amount of net income of such corporation, allocable to California, increased by the amount of such personal property taxes; provided, however, that if any such corporation sustains a net loss allocable to California the personal property taxes required to be paid by such corporation to this State or its political subdivisions during the preceding calendar year or fiscal years ended during such calendar year shall be considered for the purpose of determining such ratio only to the extent which such personal property taxes exceed such net loss allocable to California.

"The commissioner, after public hearing and opportunity given to examine the data on which his determination is based, shall determine not later than the thirty-first day of December of each year the average percentage of net income above specified, and, within thirty days after his determination, shall mail notice of his determination and the amount of tax payable on the basis of such determination to all banks and financial corporations affected thereby, which are then classified on his records as banks or financial corporations, but such determination shall not be considered a deficiency assessment within the meaning of Section 25 hereof. The data gathered by the commissioner in determining the rate, referred to herein, shall be made available to the taxpayers affected by such determination at the time and in the manner prescribed by regulations adopted by the commissioner.

"If it be judicially determined that the rate of tax on any bank or corpoartion is higher than is authorized by law such bank or corporation shall be relieved of liability for any tax imposed by this act only to the extent of the excess beyond that legally authorized." [Stats. 1949, ch. 1542, pp. 2736, 2737.]

tied that taxation of personal property, which is not a method of taxation permitted in section 5219, is improper. (Owensboro Nat. Bank v. Owensboro, 173 U. S. 664, 668 et seq. [19 S. Ct. 537, 43 L. Ed. 850]; First Nat. Bank v. City & County of San Francisco, 129 Cal. 96, 97-98 [61 P. 778].) Plaintiffs contend that the California act imposes a tax rate higher than is permitted by section 5219 and that it results in taxing their personal property.

Section 5219 is designed to allow the states considerable freedom in working out an equitable tax system, and the purpose of the limitation on the rate which may be imposed is only to prohibit discrimination in practical operation against national banks as a class. (Tradesmens Nat. Bank v. Oklahoma Tax Com., 309 U. S. 560, 567-568 [60 S. Ct. 688, 84 L. Ed. 947].) In determining whether a state tax on such banks according to or measured by net income violates the limitation, consideration must be given to the state tax structure as a whole, not merely to taxes of the kind imposed upon those banks. The state tax on them is valid so long as the resulting burden does not exceed the burden to which state banks, mercantile, business, manufacturing, and financial corporations are subject. (Tradesmens Nat. Bank v. Oklahoma Tax Com., supra, 309 U. S. 560, 567-568; see Franchise Tax Board v. Superior Court, 36 Cal. 2d 538, 551-552 [225 P. 2d 905]; H. A. S. Loan Service, Inc. v. McColgan, 21 Cal. 2d 518, 520 [133 P. 2d 391, 145 A. L. R. 349].) In Tradesmens National Bank, the court, in upholding the validity of a bank franchise tax against a claim of discrimination, took into consideration not only fran-

chise taxes imposed on nonfinancial corporations but also their income and ad valorem taxes.

Section 4a is designed to impose on banks a fair and equitable tax within the restrictions of section 5219, and the lack of any discrimination against banks is clear when the entire tax burden of other corporations is taken into consideration. (See 22 Cal. L. Rev. 499, 503-504 (1934).) As we have seen, nonfinancial corporations as well as banks pay a franchise tax of 4 per cent of their net incomes and real property taxes, and the nonfinancial corporations also pay personal property taxes. Banks are exempt from personal property taxes, and, while they pay as a franchise tax a percentage of net income in addition to the 4 per cent they pay in common with other corporations, the additional percentage is based on the ratio between the personal property taxes paid by the other corporations and the net incomes of those corporations.[3] The total percentage of net income paid by banks as franchise taxes is equal to the percentage paid by nonfinancial corporations as a group from their combined net incomes as franchise taxes and personal property taxes. Thus, if the banks are required to pay a higher percentage of their net income than some of those corporations, there are necessarily others paying a greater portion of their net income than the banks pay. It is apparent that the tax burden of the banks is not "higher than the highest of the rates" imposed upon nonfinancial corporations and is in accord with section 5219.

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[3]Section 4a of the act provides for adjustments in the computation of the additional percentage, but it is not claimed that these adjustments have any bearing on the questions before us.

The personal property of national banks, which, as pointed out above, is exempt from taxation, is not taxed either directly or indirectly by the provisions of section 4a. The amount of taxes paid by the banks under that section does not depend upon or vary in any way with the amount of personal property they own. The calculation of the tax rates does not take into account the personal property owned by banks as a class or that owned by particular banks, and the tax is measured by their income.

The fact that Congress has not permitted taxation of the personal property of banks does not mean that their tax burden should be less than that of other corporations but only that it may not be imposed in the form a personal property tax. This is evident from section 5219 of the Revised Statutes, which permits taxation of banks at the "highest" rate assessed against nonfinancial corporations. The Legislature, consistent with the federal statute, could have exempted from personal property taxes nonfinancial corporations as well as banks, imposed franchise taxes on both at the same rate, and thus denied national banks any monetary advantage from their personal property exemption. The legislative determination that the amount of taxes to be paid by nonfinancial corporations should be obtained partly by personal property taxes and partly by franchise taxes does not prevent the state from placing an equal tax burden on national banks solely in the form of franchise taxes.

It has been held in an analogous situation that, although a state may not tax the franchise of a foreign corporation whose activities in the state constitute ex-

clusively interstate commerce, a special tax at a rate equivalent to the franchise tax may be imposed on the foreign corporation in the form of a net income tax from which corporations paying the franchise tax are exempt. (West Publishing Co. v. McColgan, 27 Cal. 2d 705, 707 *et seq.* [166 P. 2d 861], aff'd 328 U. S. 823 [66 S. Ct. 1378, 90 L. Ed. 1603]; *cf.* Northwestern States Portland Cement Co. v. Minnesota, 358 U. S. 450, 457 *et seq.* [79 S. Ct. 357, 3 L. Ed. 2d 421, 67 A. L R. 2d 1292]. [Citing with approval and quoting from the West Publishing Co. case]; Gregg Dyeing Co. v. Query, 286 U. S. 472, 478 *et seq.* [52 S. Ct. 631, 76 L. Ed. 1232, 84 A. L. R. 831].) Similarly, the fact that a state may not apply its sales tax to sales of property in interstate commerce or outside the state does not prevent it from imposing a use tax, at the same rate, on use or storage in the state and exempting from that tax all property which has been previously subjected to the sales tax. (Southern Pacific Co. v. Gallagher, 306 U. S. 167, 171-172 [59 S. Ct. 389, 83 L. Ed. 586].) It is apparent that these cases go much further than we are required to go here since the taxes there under consideration were upheld even though the taxpayer was required to pay the same amount as if the tax from which he was exempt had been applied. The amount of tax the banks are required to pay is not the same as the amount they would have paid had their personal property been taxed; there is no relationship between the franchise tax imposed on them and the personal property they own.

Decisions relied upon by plaintiffs are distinguishable from the present cases because in all of them there was

a relationship between the amount to be paid under the tax held invalid and the amount of property or income as to which the taxpayer was entitled to an exemption. Moreover, all these decisions differ from the ones before us in other significant respects. In Missouri v. Gehner, 281 U. S. 313 [50 S. Ct. 326, 74 L. Ed. 870], National Life Ins. Co. v. United States, 277 U. S. 508 [48 S. Ct. 591, 72 L. Ed. 968], and Miller v. City of Milwaukee, 272 U. S. 713 [47 S. Ct. 280, 71 L. Ed. 487], the exemption which the invalid tax was held to infringe on, namely, an exemption of governmental securities, was designed to favor these securities over other property in the matter of taxation, while the purpose of the exemption of national banks from personal property taxes, as we have seen, is to prevent the states from using this form of taxing banks, not to relieve them from the duty of paying their share of the tax burden. (See 17 Cal. L. Rev. 456, 506-507 (1929).) In Frick v. Pennsylvania, 268 U. S. 473 [45 S. Ct. 603, 69 L. Ed. 1058, 42 A. L. R. 316], where the tax was upon the transfer of property at death measured by the amount of the decedent's property both within and without the state, the measure of the tax was not reasonably related to the privilege taxed insofar as property outside the state was included. The measure of the tax here, net income attributable to California, is, of course, reasonably related to the privilege of engaging in the business of banking in the state. The tax involved in Miller v. Heilbron, 58 Cal. 133, 140-141, resulted in placing a greater burden on stockholders of national banks than on stockholders of other corporations.

Use of the personal property taxes and the net incomes of nonfinancial corporations in the computation of the bank tax rate does not result in a deprivation of due process or equal protection. It is obvious that in establishing an equitable tax system and setting the rate for a particular class of taxpayers, the Legislature may consider the tax rates applicable to other classes in comparable situations. Section 5219 itself requires that in imposing taxes on national banks according to net income the Legislature must take into account the rates assessed upon nonfinancial corporations. The use of taxes paid by one group of taxpayers in order to establish a rate of tax for another group has been upheld where, as here the statutory scheme was reasonably designed to obtain equality of tax burdens. (Michigan Central Railroad v. Powers, 201 U. S. 245, 292 *et seq.* [26 S. Ct. 459, 50 L. Ed. 744]; People v. Keith Railway Equipment Co., 70 Cal. App. 2d 339, 351 *et seq.* [161 P. 2d 244].) Hoeper v. Tax Commission, 284 U. S. 206, 215 [52 S. Ct. 120, 76 L. Ed. 248, 78 A. L. R. 346], is readily distinguishable. Under the income tax held invalid there, a husband was required to pay taxes not only on his own income but also on the income of his wife over which he had no control whereas under section 4a the measure of the tax imposed upon a bank is the income of the bank, not the income of someone else.

The next question is whether plaintiffs were denied procedural due process because they were not permitted

to examine certain documents which were considered by the Franchise Tax Commissioner in setting the bank tax rate.[4] The commissioner each year compiled information as to the net incomes and personal property taxes of nonfinancial corporations from their verified franchise tax returns, from audit adjustments dealing with additional assessments and abatements, and from other materials obtained from the corporations. The information was tabulated in statistical form, and transcripts of the returns were made which contained the property tax and net income figures with serial numbers instead of names being used to designate the corporations. Two reports containing a proposed tax rate were prepared, one showing an over-all computation and the other a computation by industrial groupings. At hearings held by the commissioner the banks were permitted to inspect the transcripts and the statistical material, and members of the commissioner's staff, having possession of the original returns, answered questions as to their contents so that the list furnished plaintiffs could be checked for accuracy so far as this could be done without disclosing the names of the corporations. Since 1941 the banks have sought at every hearing to examine the original returns and other documents which would show the identity of the nonfinancial corporations. The commissioner has denied ac-

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[4]Defendant, Franchise Tax Board, succeeded to the powers of the Franchise Tax Commissioner in 1950. (Stats. 1949, ch. 1188, p. 2108.)

cess to these materials on the ground that section 35 of the act prohibits such a disclosure."

After the hearings the commissioner set the tax rates for banks and other financial corporations. The rates he adopted were the same as the proposed rates in all years except 1943 and 1945, when they were higher. For the years 1933-1941, the rates set were the maximums permitted under section 4a, *i.e.*, 6 per cent and 8 per cent. They varied between 5.9955 per cent and 7.89 per cent during the remaining years.

Material in addition to that given to plaintiffs at the hearings was made available to them at the trial. They were given information as to the names and addresses of the nonfinancial corporations, filing dates of the returns and private addresses of officers and directors. This was done in such a manner that plaintiffs would not be in a position to connect any of the corporations with the income information previously supplied under serial numbers. With respect to the personal property tax data used by the commissioner, an offer was made to provide, with certain exceptions, the names of the corporations together with the amount of

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[5]With certain exceptions not relevant here, section 35 provides: "(a) . . . it shall be unlawful for the commissioner, . . . to divulge or make known in any manner the amount of income or any particulars relating to the business affairs of the bank or corporation set forth or disclosed in any report or return required under this act; . . . Nothing herein shall be construed to prohibit the publication of statistics, so classified as to prevent the identification of particular reports or returns and the items thereof, or the publication of the percentage of dividends paid by any bank or corporation. . . . (b) Any offense against this section shall be a misdemeanor." [Stats. 1943, ch. 352, p. 1464.]

tax each had paid.[6] This offer was rejected by plaintiffs. Defendant also offered on several occasions to comply with any other reasonable method of verification which might be proposed by plaintiffs, and as far as appears no request for production was refused where it could have been granted without violating section 35.

The question whether plaintiffs are entitled to inspect the original tax returns was before us in Franchise Tax Board v. Superior Court, 36 Cal. 2d 538 [225 P. 2d 905]. We there issued a writ prohibiting enforcement of a trial court order, entered in the refund actions for 1943, permitting plaintiffs to inspect parts of the original tax returns filed by approximately 25,000 corporations. In that case plaintiffs contended, as they do here, that, where the determination of the tax rate is delegated to an administrative official, due process requires that at some stage of the proceedings, either at the administrative or judicial level, the taxpayer be permitted to examine all the data upon which the tax rate is predicated, including the original tax returns. (36 Cal. 2d at p. 544.)

The constitutional issue was treated at length in Franchise Tax Board v. Superior Court, *supra*, 36 Cal. 2d

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[6]This offer did not include figures for the years 1933-1936 because statistics for those years had not been preserved. Information as to corporations having net losses was also omitted from the offer since it would have enabled plaintiffs, if they considered it with other information available to them, to determine the amount of net loss of each corporation, in violation of section 35. According to defendant, the net-loss corporations ordinarily accounted for less than 1 per cent of the personal property taxes entering into the computations.

538, and it was resolved adversely to plaintiffs. The opinion pointed out that plaintiffs' position regarding due process was based on the erroneous assumption that in determining the tax rate the commissioner was acting quasi-judicially, whereas in fact he was acting in a quasi-legislative capacity. It was stated: "There is no constitutional requirement for any hearing in a quasi-legislative proceeding. 'Where a rule of conduct applies to more than a few people it is impracticable that every one should have a direct voice in its adoption. The Constitution does not require all public acts to be done in town meeting or an assembly of the whole. General statutes within the state power are passed that affect the person or property of individuals, sometimes to the point of ruin, without giving them a chance to be heard. Their rights are protected in the only way that they can be in a complex society, by their power, immediate or remote, over those who make the rule. If the result in this case had been reached as it might have been by the State's doubling the rate of taxation, no one would suggest that the Fourteenth Amendment was violated unless every person affected had been allowed an opportunity to raise his voice against it before the body entrusted by the state constitution with the power.' (Bi-Metallic Inv. Co. v. State Board of Equalization. 239 U. S. 441, 445 [36 S. Ct. 141, 60 L. Ed. 372].) . . . The banks argue that the tax returns lost whatever privileged status they may have had through their use by the commissioner 'against' the banks. . . . An agency performing [a quasi legislative] function does not legislate 'against' the taxpayer. . . . The proceedings were in no sense adverse. . . . [They] were subject to legislative control, if desired, through

examination of the tax returns by one of its committees." (36 Cal. 2d at pp. 549-551.)

There is no sound basis for concluding, as plaintiffs assert, that our decision of the constitutional issue related solely to the administrative hearing, not to the court actions. The inspection order of the trial court was entered in the 1943 refund actions, after the administrative hearing relating to that year had been concluded, and the contention of plaintiffs regarding due process was made with respect to the actions as well as to the hearing. The reasoning used by the court in rejecting that contention was equally applicable to both, and the writ we issued was to prohibit inspection of the original tax returns in the judicial proceedings. There was no reason to discuss the due process question unless the court intended to decide that withholding inspection in those proceedings would not affect the validity of the tax rate.

It must be kept in mind that the denial of access to the original tax returns does not prevent plaintiffs from attacking the propriety of the rate. The nondisclosure provisions of section 35 mean merely that plaintiffs "are confronted with the common situation wherein proof of alleged facts is rendered more difficult because of the existence of certain privileged communications, protected as such because underlying public interests and policies outweigh the convenience of a particular litigant." (Franchise Tax Board v. Superior Court, *supra*, 36 Cal. 2d 538, 551.) Much material helpful to plaintiffs in determining the accuracy of the rate was made available to them at both the administrative hearings and the trial, and the only information

withheld was such that it would have revealed to them, contrary to section 35, the amount of income or the business activities reported by named nonfinancial corporations. We are satisfied that plaintiffs received all the information they reasonably needed.

The cases of Ohio Valley Water Co. v. Ben Avon Borough, 253 U. S. 287 [40 S. Ct. 527, 64 L. Ed. 908], and Ohio Bell Telephone Co. v. Public Utilities Com., 301 U. S. 292 [57 S. Ct. 724, 81 L. Ed. 1093], relied on by plaintiffs, are distinguishable. Each involved the regulation of rates of a single public utility, not, as here and in Bi-Metallic Inv. Co. v. State Board of Equalization, 239 U. S. 441 [36 S. Ct. 141, 60 L. Ed. 372], a tax determination applicable to numerous persons. The Ben Avon case held that where a utility claims confiscation will result from a rate order, the utility is entitled to a fair opportunity to submit that issue to a judicial tribunal for determination upon its own independent judgment. (But see discussion of subsequent federal cases in 4 Davis, Administrative Law Treatise (1958), §29.09, pp. 163 et seq.) Plaintiffs in the present cases obtained an independent judicial determination as to the validity of the tax rates after a fair opportunity to present evidence in support of their position. In the Ohio Bell Telephone case the commission made a rate order, relying on statistics and trade journals which had not been received in evidence at the administrative hearing, and the utility was not advised of what had occurred until after the order was made. The judicial review which followed was limited to a consideration of the record before the commission, and the utility was never given an opportunity

to rebut the evidence not in the record. In holding that the utility had been denied due process, the court recognized that a different question would have been presented if the commission's order had been subject to attack in an independent action (301 U. S. at p. 303), and the case is consistent with the proposition that evidence outside the record may be used so long as its use is made known to the parties and they are given an opportunity to rebut it (see 2 Davis, Administrative Law Treatise (1958), §15.12, pp. 415-416). In the present cases plaintiffs were informed of the material relied upon by the commissioner as discussed above, and thereafter they were given opportunities for reasonable verification of that material and for attacking the rates by introducing any relevant, nonprivileged evidence.

Plaintiffs assert that, in determining the amount of personal property taxes of nonfinancial corporations, the commissioner used figures not in accord with the provisions of section 4a. They point out that the commissioner accepted as conclusive the classification made by the assessing authorities as to whether property of nonfinancial corporations was realty or personalty. It was shown at the trial that trade fixtures and other real property of those corporations had been misclassified by some assessing authorities as personal property.

The amount of personal property taxes of nonfinancial corporations to be taken into consideration by the commissioner is described in section 4a as the amount "required to be paid" as personal property taxes. The commissioner has in effect construed the quoted language as referring to the amount which the assessing

authorities have required to be paid rather than, as plaintiffs urge, the amount which the assessors should have required to be paid. The construction adopted by the commissioner is clearly reasonable. As we have seen, personal property taxes on nonfinancial corporations are taken into account for the purpose of achieving equality between those corporations and the banks, and the construction that results in considering the amounts assessors have required to be paid is in accord with that objective. Moreover, errors that may occur in assessments may be favorable to the banks as well as unfavorable. On the other hand, if plaintiffs' construction were adopted and the determinations made by the assessors were not conclusive, the administration of the bank tax would be extremely burdensome and would involve considerable duplication of the work of the assessors. The commissioner would not only be compelled to reclassify property but would also be subject to additional burdens such as reevaluation of the property and redetermination of exemptions. The Legislature could not have intended such a result. It should also be noted that the trial court found that the procedures used by the commissioner achieved a "rough approximation" of the rates which would have been imposed if no misclassification had occurred.

The inclusion of the personal property taxes paid by cooperatives in the computations of the commissioner resulted in higher bank tax rates than would otherwise have been applicable, and plaintiffs contend that those taxes should not have been included. They point out that under section 4a the personal property taxes paid by a corporation having a net loss may be included in

the computations only to the extent those taxes exceed the amount of net loss, and they assert that, if the net income of cooperatives had been correctly calculated, every cooperative would have had a net loss in excess of its personal property taxes. It is plaintiffs' position that cooperatives, in determining their net income, may deduct all operating expenses and are also, with respect to business done with members and done with nonmembers on a nonprofit basis, entitled to a reduction of the gross income under subdivisions (l) and (m) of section 8 of the act, which provide that cooperatives may deduct all income from such business.

The determination of net income of cooperatives is important primarily for the purpose of ascertaining the franchise tax which the cooperatives themselves must pay and only indirectly for the purpose of computing the bank tax rate. The method of calculation urged by plaintiffs would give cooperatives an unwarranted benefit closely akin to a double deduction because they would be entitled to deduct, in addition to gross income from membership and nonprofit business, all operating expenses, which would include those attributable to the production of that income. Thus cooperatives would always have a loss from their cooperative business in the amount that expenses were incurred in carrying on that business, and this loss would substantially, if not entirely, offset income from profit-making activities, which should be taxable. In the present cases the trial court found that under the method of calculation urged by plaintiffs all cooperatives would have net losses for the years in question.

The commissioner's method of calculating the income of cooperatives, on the other hand, has the sensible result of treating them, so far as they engaged in profit-making business, like any other corporation subject to the franchise tax. He treated the deduction permitted by subdivisions (l) and (m) of section 8 as the gross income from members and nonprofit business minus the expenses incurred in producing that income. This treatment led to the result that, as to member and nonprofit business, the cooperatives had no income or loss and that net income or loss depended upon the difference, if any, between the gross income from activities with nonmembers on a profit basis and the business expenses allocable to the production of such income.

Even if it were assumed that the deduction permitted by subdivisions (l) and (m) of section 8 is the entire gross income from member and nonprofit business, the cooperatives, contrary to plaintiffs' position, would not be entitled to also deduct business expenses incurred in producing that income. Subdivision (d) of section 9 of the act provides that in computing net income no deduction shall be allowed for any "amount otherwise allowable as a deduction which is allocable to one or more classes of income not included in the measure of the tax imposed by this act." Application of this subdivision in calculating the net income of any cooperative will lead to the same result as is reached under the commissioner's method.

Plaintiffs assert that it is illegal to include in the measure of the tax income from exempt governmental securities. They do not dispute that a state may impose a franchise tax on banks measured by net income from all sources, including exempt governmental securities (Tradesmens Nat. Bank. v. Oklahoma Tax Com., 309 U. S. 560, 564-567 [60 S. Ct. 688, 84 L. Ed. 947]; Pacific Co., Ltd. v. Johnson, 212 Cal. 148, 154 et seq. [298 P. 489] [aff'd, Pacific Co. v. Johnson, 285 U. S. 480, 489 et seq. [52 S. Ct. 424, 76 L. Ed. 893]), but they contend that the California tax is one measured by gross rather than net income. It is obvious from the provisions of the act (e.g., §§4, 7 and 8) that there is no merit in this contention. Although Rosemary Properties, Inc. v. McColgan, 29 Cal. 2d 677 [177 P. 2d 757], and Burton E. Green Inv. Co. v. McColgan, 60 Cal. App. 2d 224 [140 P. 2d 451], interpret one provision of the act not involved here as referring to gross income, they expressly recognize that the tax is calculated on the basis of net income. (29 Cal. 2d at p. 681; 60 Cal. App. 2d at p. 231.)

The judgments are affirmed.

Schauer, *J.*, Peters, *J.*, White, *J.*, Peek, *J. pro tem.*,* Draper, *J. pro tem.*,* and Tobriner, *J. pro tem.*,* concurred.

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*Assigned by Chairman of Judicial Council.

Judgments Below as Entered in the Minutes.

San Francisco, Feb. 23, 1961.

IN BANK.

Sac. 6952-6968—Security First National Bank of Los Angeles v. Franchise Tax Board;

Sac. 6969-6981—Bank of America National Trust and Savings Association v. Franchise Tax Board;

Sac. 6982-6996—The Farmers and Merchants National Bank of Los Angeles v. Franchise Tax Board. The judgments are affirmed. Gibson, *C. J.* We concur: Schauer, *J.*; Peters, *J.*; White, *J.*; Peek, *J. pro tem.*; Draper, *J. pro tem.*; Tobriner, *J. pro tem.*

Opinion of the Superior Court for Sacramento County.

At the conclusion of the trial of this case, I felt that it would be necessary, after reading the briefs and hearing all arguments, to write a long opinion reviewing the evidence in great detail, setting forth the history of the act, the experience of the litigants under it, and discussing all the points raised and the authorities considered. After reading and considering the briefs with great care, I am of the opinion that the writing of such a memorandum decision would be a waste of time. Eight years have elapsed since I was first assigned to the trial of this case; more than 2½ years have elapsed since the last evidence was admitted, and to write the kind of opinion first contemplated would add several months more to the total time consumed. The cases have been most ably and exhaustably briefed with full citation of all authorities that have any bearing on the problems presented, and from the standpoint of the litigants, their attorneys, and the reviewing courts, a simple reference to the briefs will be sufficient in all cases to enable them to do whatever needs to be done from this point on. The briefs have been printed and no doubt there are sufficient copies for the use of everyone concerned. All that is necessary at the present time is an indication of my views on the vital points involved, sufficient to inform counsel on both sides of the nature of the findings that I am prepared to sign, and the nature of

the judgments that would follow. To go beyond this, under the circumstances, would simply be an attempt to display my erudition, or—what is more likely—to expose the lack of it. I shall therefore content myself with a brief discussion of my views concerning some of the more important phases of the cases, and the citation of a few authorities essential to such discussion, followed by appropriate references to the trial briefs when necessary.

From the time of my first conference with counsel in this case, and at all times throughout the trial, I have felt that I should be extremely liberal on the question of admissibility of evidence so that a complete record might be made which would enable reviewing courts to pass squarely upon every question presented, to the end that many of these important and troublesome questions might be definitely and finally settled. There have been a number of instances where I may have gone beyond the bounds of liberality in admitting evidence of questionable relevancy, but in view of the complex nature of the case it seemed desirable that I be put in a position to see the whole picture before making final rulings on some of the evidence thus offered. Two considerations prompted me to admit certain evidence might otherwise have been excluded: first, the difficulties of proof brought on by the non-disclosure provisions of the act itself; and, two, the declaration of the United States Supreme Court in the Tradesmen's case to the effect that in order to determine whether or not there had been discrimination against national banks, it would be necessary to examine the whole tax structure of the

State. There are now pending for decision several motions to strike certain evidence which was admitted during the trial. I have considered all such evidence in arriving at my conclusion and *the several motions to strike are therefore ordered denied.*

From the beginning of this case I have been constantly reminded that a great deal of confusion and feelings of frustration, injustice and lack of fair play arose from the fact that the plaintiffs were measuring their rights with reference to established practices that have arisen and been recognized in connection with ad valorem taxes; and perhaps because of my own experience with such problems, I may have felt very keenly at times throughout the trial that whether or not the amount of tax imposed was correct and fair, the very nature of the tax and the methods adopted for its determination made it necessary for the taxpayers to accept on faith the burden of paying taxes without the privilege of exploring in every detail the processes which went into the computation of the rates. It is difficult to apply the principle of walking by faith instead of by sight to a tax proceeding. It is somewhat difficult at times to see rights which have been established under the processes of ad valorem taxation completely ignored or set aside by a declaration that a given tax is not of that nature, but is a franchise or privilege tax. This applies with particular force to such things as the inclusion of interest from tax-exempt securities. Such exemptions are granted and recognized not only because of the peculiar nature of our dual sovereignties in this country, but also because the issuing bodies find a more ready sale for

their securities when the purchaser is offered exemption from taxation. Yet, by the simple legerdemain of denominating the tax a privilege tax, the purchaser is denied the exemption which probably induced him to make the purchase in the first instance, and finds that his original purpose has been completely thwarted. That this proposition has been a cause of worry and has been seriously questioned is attested by the number of dissenting opinions that occur on the subject. However, if any doubt remains I think it was definitely settled in the Trademen's case. I think there can be no question concerning the purpose of Congress when it authorized states to act under a fourth method of taxation as prescribed by the amendment to Section 5219 of the Revised Statutes. It is difficult to see what Congress could have meant by the use of the phrase "according to or measured by" if it did not intend to permit exactly the kind of tax which California has imposed.

As has been pointed out by defendant, national banks are, for most purposes, simple private corporations financed by private individuals permitted to organize under the authority of the Federal government because the Federal government, for certain purposes, wishes to use the services of such banks in carrying on its own activities. Inasmuch as Congress has authorized their creation and prescribed the limits of their activities, there appears to be absolutely no doubt under all the authorities that Congress likewise has the authority to authorize such taxes upon such instrumentalities as it desires to permit, subject only to such constitutional restrictions as apply to all corporations.

The question has been argued at considerable length whether the use of the word "rate" in the act, actually means arithmetical rate or whether it means the burden of taxation. I have never had any doubt on this point. Even though the word "rate" was used in the act, the other provision of the act itself, and all authorities which have any bearing on the point, support the conclusion that what we are dealing with here is comparative tax burdens. Indeed, if we had been confronted only with the question of arithmetical rate these cases would have been settled years ago.

The early California Heilbron case was decided many years before Congress authorized the fourth method of taxation, and if I am correct in my construction of Section 5219 as it now stands and of the authorities dealing with privilege taxes, the contention that the Heilbron case is of importance in the consideration of these problems is disposed of. The tax situation as it existed in California many years immediately prior to the adoption of the present act is well understood. Here, as elsewhere, there were people no doubt who wanted to impose excessive burdens upon the banks and there were also many who felt that they were being discriminated against because of the exemption of personal property taxes extended to such banks. There can be absolutely no question that the purpose of the present act was to equalize tax burdens, and it would be absurd to argue or contend that the act was not designed to destroy the preferential treatment of banks resulting from their exemption from personal property taxes. Notwithstanding statements made at the time of the adoption of the first act which might tend to

support the conclusion that this was simply a subterfuge to destroy the exemption of tax-free securities, I cannot believe that this was the sole motive or that the situation was such as to bring it within those cases which have held that when the sole motive was to destroy the tax exemption, the tax was invalid. In the first place, such cases as the Tradesmen's case indicate very clearly that the Supreme Court will probably not recognize such cases as controlling at the present time, and if Congress had the right to permit a tax on national banks according or measured by net income—and I think it had—the legislature was well within its rights in acting pursuant to such authorization, and I think it is only fair to attribute to the legislature a desire to equalize tax burdens within the state.

I have already expressed my views strongly to counsel on the non-disclosure provisions of the act. While I think that the purpose which motivated the legislature enacting such provisions was laudable, it is my considered opinion, growing out of the experiences of the trial of these cases, that as applied to a court proceeding, they are both vicious and unnecessary. However, in Franchise Tax Board v. Superior Court, 36 Cal. 2d 538, the Supreme Court of this State has upheld such provisions, and there is nothing more for me to say on the point. While it was said by the Court in that case that they did not pass directly upon the constitutionality of the act, it seems to me that the holdings in that case necessarily strike a death blow to many of the contentions of plaintiffs in these cases. While it offends my sense of fair play, I am constrained to hold that defendants' contentions concerning

the effect of the decision are correct. While I had grave doubts on some of these questions at the time of trial, I have finally concluded that if the rate fixed does not exceed the limits fixed by Congress, it must be upheld.

There is absolutely no doubt in my mind that under these circumstances there are times when errors of many kinds may result in the paying of a higher rate than would have been fixed if the computations and basic data had been free from error; and this applies also to the question of misclassification of property by county and city assessors. That there has been such widespread misclassification I think has been established beyond doubt, and that at times it has resulted in a higher tax than would have been applied otherwise, also seems clear; but notwithstanding the testimony of such witnesses as Mr. Boles and Professors Jacoby and Weston, I am satisfied that plaintiffs have not sustained the burden of proving that a rate has been imposed which is higher than the rate assessed upon other financial corporations or higher than the highest rate assessed upon mercantile, manufacturing and business corporations. Frankly, I do not like some of the procedures or the obstacles thrown in the way of the taxpayer under such circumstances, but they may be justified by the intolerable situation which existed concerning national banks prior to the adoption of the present act. In any event, I am of the opinion that the authorities support the conclusion that a rough approximation is all that is to be expected, and if it does not violate one of the two standards set by Section 5219 of the Revised Statutes, that it is valid, notwithstand-

ing the fact that the taxpayer might have saved money if he had been able to prove that there were errors which affected the rate. This seems to be justified upon the ground of practical tax administration.

I have considered the contentions of plaintiffs respecting the holding in the Rosemary Properties case, but in my opinion it is not authority for holding that the tax is one on gross profits.

I have not discussed the question of the sufficiency of claims for refund, because in view of the conclusions I have reached, those questions become immaterial.

The fact that I have not discussed specifically the constitutional questions or many other related subjects does not mean that I have not considered them. I have read the briefs with care and the authorities, and with some reluctance on certain points I have concluded that the contentions of the Attorney General, with some minor exceptions which do not change the final result, are sound and that the position of the defendants must be upheld throughout.

Defendants will therefore submit findings and judgments in accordance with the views herein expressed, and it is hoped that it will be possible by stipulations to work out a set of master findings to cover all the cases.

Dated January 14, 1956.

C. A. Paulsen,
Judge of the Superior Court.

Filed Jan. 19, 1956.

C. C. LaRue, Clerk, By D. McIntyre, Deputy.

California Bank and Corporation Franchise Tax Act, Section 1.

SECTION 1. TAX ON NATIONAL BANKS. Every national banking association located within the limits of this State, shall annually pay to the State a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, upon the basis of its net income for the next preceding fiscal or calendar year at the rate provided for in Section 4a hereof. The State is hereby adopting the method numbered (4) authorized by Title 12, Section 548, United States Code.

California Bank and Corporation Franchise Tax Act, Section 4a.

SECTION 4a. RATE OF TAX ON BANKS AND FINANCIAL CORPORATIONS. The rate of tax on National banking associations and other banks and financial corporations mentioned in Sections 1, 2 and 4 of this act, shall be a percentage equal to the percentage of the total amount of net income, allocable to this State, of every corporation taxable under subdivision (3) of Section 4 of this act, other than public utilities as defined in the Public Utilities Act, for the next preceding calendar year or fiscal years ended during such calendar year, required to be paid to this State as franchise taxes according to or measured by such net income, and required to be paid to this State or its political subdivisions by such corporations as personal property taxes during the preceding calendar year or fiscal years ended in such calendar year; provided, however, that said rate of tax shall not exceed 8 per-

centum. The percentage of the net income of every corporation taxable under subdivision (3) of Section 4 of this act, other than public utilities as defined in the Public Utilities Act, required to be paid to this State or its political subdivisions in personal property taxes shall be determined by ascertaining the ratio which the total amount of such personal property taxes, less 4 percentum thereof, bears to the total amount of net income of such corporation, allocable to California, increased by the amount of such personal property taxes; provided, however, that if any such corporation sustains a net loss allocable to California the personal property taxes required to be paid by such corporation to this State or its political subdivisions during the preceding calendar year or fiscal years ended during such calendar year shall be considered for the purpose of determining such ratio only to the extent which such personal property taxes exceed such net loss allocable to California.

The Commissioner, after public hearing and opportunity given to examine the data on which his determination is based, shall determine not later than the thirty-first day of December of each year the average percentage of net income above specified, and, within 30 days after his determination, shall mail notice of his determination and the amount of tax payable on the basis of such determination to all banks and financial corporations affected thereby, which are then classified on his records as banks or financial corporations, but such determination shall not be considered a deficiency assessment within the meaning of Section 25 hereof. The data gathered by the Commissioner in determining

the rate, referred to herein, shall be made available to the taxpayers affected by such determination at the time and in the manner prescribed by regulations adopted by the commissioner.

If it be judicially determined that the rate of tax on any bank or corporation is higher than is authorized by law such bank or corporation shall be relieved of liability for any tax imposed by this act only to the extent of the excess beyond that legally authorized.

California Bank and Corporation Franchise Tax Act, Section 23.

Section 23. TIME TAXES PAYABLE AND DELINQUENT. BANKS AND FINANCIAL CORPORATONS, FIRST INSTALLMENT. On or before the fifteenth day of the third month following the close of the income year, as defined in Section 11 hereof, there shall be due and payable, from every National banking association, every other bank, and every financial corporation, of the classes mentioned in Sections 1, 2 and 4 of this act, as a first installment of the tax on such banks and financial corporations, a percentage of their net income as disclosed by the return, which is equal to that percentage of the net income of corporations of the classes referred to in Subdivision (3) of Section 4 of this act, which is required to be paid to the State as a franchise tax according to or measured by net income; except, that the first installment of the tax on financial corporations shall not be less than the minimum of twenty-five dollars ($25).

BANKS AND FINANCIAL CORPORATIONS, SECOND INSTALLMENT. On or before the fif-

teenth day following the mailing of notice of the commissioner's determination of the average percentage of net income of corporations of the classes referred to in Subdivision (3) of Section 4 of the act, other than public utilities as defined in the Public Utilites Act, required to be paid to the State or its political subdivisions in franchise and personal property taxes as provided in Section 4a of this act, or on or before the fifteenth day of the ninth month following the close of the income year as defined in Section 11 hereof, whichever is later, there shall be due and payable from every such banking association, bank, and financial corporations, a percentage of their net income as disclosed by the return which is equal to the percentage of the net income of corporations of the classes referred to in Subdivision (3) of Section 4 of this act, other than public utilities as defined in the Public Utilities Act, required to be paid to the State or its political subdivisions as personal property taxes as determined by the commissioner; provided, however, that the sum of the first and second installments shall not exceed 8 percentum of the net income of each such banking association, bank, and financial corporation. The offset herein provided for shall be applied to such second installment.

CORPORATIONS. In the case of corporations of the classes referred to in subdivision (3) of Section 4 of this act, one-half the amount of tax disclosed by the return shall be due and payable as a first install-

ment of the tax on such corporations on or before the fifteenth day of the third month following the close of the income year, as defined in Section 11 hereof. The balance of the tax shall be due and payable as a second installment on or before the fifteenth day of the ninth month following the close of the income year. A tax imposed by this act or any installment thereof may be paid at the election of the taxpayer, prior to the date prescribed for its payment.

WHERE TIME FOR FILING RETURNS EXTENDED. Where an extension of time for filing returns has been granted by the commissioner under the provisions of Section 15 of this act, the first installment shall be paid prior to the expiration of such extension.

METHOD OF PAYMENT. All taxes and interest imposed under this act must be paid to the commissioner in the form of remittances payable to the Franchise Tax Commissioner, and he shall transmit such payments daily to the State Treasurer.

MONEY DEPOSITED IN SPECIAL FUND. All moneys received by the State Treasurer shall be deposited by him in a special fund in the State Treasury, to be designated the Bank and Corporation Franchise Tax Fund, and moneys in said fund shall, upon the order of the State Controller, be transferred into the General Fund of the State, or drawn therefrom for the purpose of refunding to taxpayers hereunder.

California Bank and Corporation Franchise Tax Act, Section 35.

Section 35. INFORMATION TO BE CONFIDENTIAL. (a) Except in accordance with proper judicial order in cases or actions instituted for the enforcement of the provisions of this act or for the prosecution of violations of this act and except as otherwise herein provided, it shall be unlawful for the commissioner, any deputy, agent, clerk or other officer or employee, to divulge or make known in any manner the amount of income or any particulars relating to the business affairs of the bank or corporation set forth or disclosed in any report or return required under this act; provided, however, that such information may upon request of a committee appointed by either the Assembly or the Senate be furnished to such committee, but it shall be unlawful for such committee or any member, clerk or other officer or employee thereof to divulge or make known in any manner any particulars of the information so furnished except to law enforcement officers for the purpose of aiding the detection or prosecution of crimes committed in violation of this act. Nothing herein shall be construed to prohibit the publication of statistics, so classified as to prevent the identification of particular reports or returns and the items thereof, or the publication of the percentage of dividends paid by any bank or corporation which is deductible by the recipients thereof under the provisions of this act or the Corporation Income Tax Act.

or the inspection by the Attorney General or other legal representatives of this State, of the report or return of any taxpayer who shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted to recover any tax or any penalty imposed by this act. Reports and returns shall be preserved for four years and thereafter until the commissioner orders them to be destroyed.

The term "business affairs," as herein used, means the details relative to the business activities of the corporation as disclosed by the return but shall exclude extraneous matters, such as the exact corporate title, corporate number, the date of commencement of business in this State, taxable year adopted, filing date of return, name, date and title of persons signing affidavit to the return, due date of taxes, taxes unpaid, taxpayer's address, private address of officers and directors.

(b) Any offense against this section shall be a misdemeanor.

(c) Notwithstanding the provisions of subsection (a), the commissioner may permit the Commissioner of Internal Revenue of the United States, or other tax officials of this State, or the proper officer of any State imposing an income tax or tax measured by income, or the authorized representative of either such officer, to inspect the returns of any bank or corporation, or may furnish to such officer or his authorized representative an abstract of the return of income of

any taxpayer or supply him with information concerning any item of income contained in any return, or disclosed by the report of any investigation of the income or return of income of any taxpayer; but such permission shall be granted or such information furnished to such officer or his representative, only if the statutes of the United States or of such other state, as the case may be, grant substantially similar privileges to the proper officer of this State charged with the administration of this act. The information furnished or secured pursuant to this subsection shall be used solely for the purposes of administering the tax acts administered by the person or agency obtaining it, and unwarranted disclosures or uses of such information by such person or agency, or the employees or officers thereof, shall be subject to the penalty provisions of this section.

(d) Whenever under this act, or any act heretofore or hereafter enacted, the commissioner is permitted or required to disclose information, or furnish abstracts, or permit access to his records to, or by any official, department, bureau, or agency of this State (including its political subdivisions), or any other state, or the United States, he may charge such official, department, bureau or agency for the reasonable cost of such services.

Revised Statutes of the United States, Section 5219 (12 U. S. C. §548).

§548. STATE TAXATION.

The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income, provided the following conditions are complied with:

1. (a) The imposition by any State of any one of the above four forms of taxation shall be in lieu of the others, except as hereinafter provided in subdivision (c) of this clause.

(b) In the case of a tax on said shares the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks: *Provided*, That bonds, notes, or other evidences of indebtedness in the hands of individual citizens not employed or engaged in the banking or investment business and representing merely personal investments not made in competition with such business, shall not be deemed moneyed capital within the meaning of this section.

(c) In case of a tax on or according to or measured by the net income of an association, the taxing State may, except in case of a tax on net income, include the entire net income received from all sources, but the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing, and business corporations doing business within its limits: *Provided, however,* That a State which imposes a tax on or according to or measured by the net income of, or a franchise or excise tax on, financial, mercantile, manufacturing, and business corporations organized under its own laws or laws of other States and also imposes a tax upon the income of individuals, may include in such individual income dividends from national banking associations located within the State on condition that it also includes dividends from domestic corporations and may likewise include dividends from national banking associations located without the State on condition that it also includes dividends from foreign corporations, but at no higher rate than is imposed on dividends from such other corporations.

(d) In case the dividends derived from the said shares are taxed, the tax shall not be at a greater rate than is assessed upon the net income from other moneyed capital.

2. The shares of any national banking association owned by nonresidents of any State shall be taxed

by the taxing district or by the State where the association is located and not elsewhere; and such association shall make return of such shares and pay the tax thereon as agent of such nonresident shareholders.

3. Nothing herein shall be construed to exempt the real property of associations from taxation in any State or in any subdivision thereof, to the same extent, according to its value, as other real property is taxed.

4. The provisions of section 5219 of the Revised Statutes of the United States as in force prior to March 25, 1926, shall not prevent the legalizing, ratifying, or confirming by the States of any tax heretofore paid, levied, or assessed upon the shares of national banks, or the collecting thereof, to the extent that such tax would be valid under said section. R. S. §5219; Mar. 4, 1923, c. 267, 42 Stat. 1499; Mar. 25, 1926, c. 88, 44 Stat. 223.

Pertinent Discussions in Congress Relative to the 1926 Amendment of R. S. 5219.

(From House Report No. 526, Sixty-ninth Congress; First Session):

"The language of the pending bill is broad enough to permit a state that imposes corporate excise or franchise taxes which are not based on income to apply the net income method to national banking associations, provided the burden of tax is no higher than that imposed upon other corporations generally *under such excise or franchise tax.*"* [67 Cong. Rec., Pt. 6, p. 5762: 16 Rep. Tr. 4196.]

(Discussions):

"Mr. McLean: The Senator will see that the record this morning contains a full explanation of the purport of the bill. I will say to the Senator that the purpose of it is to give the states which now have an income tax the right to tax the incomes of national banks *in the same manner* in which they tax the incomes of other corporations in the state. . . ." [*Ibid.*, p. 5822: 16 Rep. Tr. 4199.]

"Mr. McLean: It gives the states the right to tax the incomes of national banks *on the same basis* that the incomes of other corporations are taxed.

"Mr. Smoot: It gives the states simply one more method than they have under the existing law.

*Emphasis here, as elsewhere, is supplied.

"Mr. McLean: If the States have an income tax, they can tax the incomes of the national banks *the same as they do* those of the state banks." [*Ibid.*, p. 5822: 16 Rep. Tr. 4200.]

(Mr. McFadden, Reading from House Report No. 526): "In the states which now apply the net income tax method to corporations generally and denominate it an excise or a franchise tax, the practice is to include income from all sources, including income from tax exempt securities, in arriving at the measure of the tax based on the net income. Therefore, it is desirable, in order to establish *complete taxing parity,* to remove any question as to the inclusion of the income from tax exempt securities as part of the measure of the tax based on the net income of national banking associations; so that the *same basis* of measuring the tax according to net income for corporations generally may be applied to national banking associations by the taxing state." [*Ibid.*, pp. 6083-6084: 16 Rep. Tr. 4210.]

"Mr. McFadden: . . . Now, the amendment particularly before us proposed that *they shall not be taxed at a higher rate than net income of manufacturing industries within the state* or at a higher rate than other banks within the state are taxed, and the national banks feel that is perfectly right, especially in view of the turn to the income tax method now pursued by these two particular states. and which undoubtedly will be followed by many of the other states." [*Ibid.*, p. 6084, 16 Rep. Tr. 4213.]

"Mr. McFadden: Yes; or, if as this bill provides, then on a net income basis, *but no higher than they tax their own industries on their net incomes.*" [*Ibid.*, p. 6084: 16 Rep. Tr. 4216.]

(Mr. McFadden) ". . . By this provision we are adding a new method of *taxing the income, but it must not be at a greater rate* than they tax their own industries, manufacturing industries and state banks." [*Ibid.*, p. 6084: 16 Rep. Tr. 4216.]

(Mr. Wingo) ". . . There is but one change and that is made an existing law by this bill and that is to give the states one additional method of taxation of national banks to what they already have under existing law. That is the only change that is made." [*Ibid.*, p. 6085: 16 Rep. Tr. 4219.]

(Mr. Wingo) "All that we do in this bill is to follow the same old rule of protecting these banks against discrimination. *Just so you use the same yardstick in measuring the volume or the extent on the taxes of the national bank that you use for other corporations in the State all right.*" [*Ibid.*, p. 6087: 16 Rep. Tr. 4236-4237.]

(Mr. Stevenson) "Now what do we do by this bill? They came to us with this proposition: Allow us to use the entire income of the bank as the yardstick upon which to measure the levy of a tax on the right to do business, and the entire income includes income from tax exempt securities and those that are not tax exempt, and then allow us to tax the dividends in the hands of the stockholder who is a resident of the state in his taxable

income; allow us to do both of those things and not make it in the alternative. In doing that, however, *we agree that we will not tax them higher than we do the income* and the dividends from mercantile and manufacturing and other business corporations.

"We have written that into the law. *That is what this adds to the methods of taxation. . . .*" [*Ibid.*, p. 6088: 16 Rep. Tr. 4244.]

(Mr. Stevenson) ". . . We are conferring that additional right, and limit it by the provision that *you cannot tax one of the banks at a greater rate than you are taxing the ordinary business corporation,* and that is their protection. . . ." [*Ibid.*, pp. 6088-6089: 16 Rep. Tr. 4249.]

(Mr. Stevenson) "Now we have this provision *so that the business corporations of the country will be a protection and a shield against discriminatory and confiscatory legislation against the national banks. . . .*" [*Ibid.*, p. 6089: 16 Rep. Tr. 4249.]

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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 122

SECURITY-FIRST NATIONAL BANK OF LOS ANGELES,
Appellant,
vs.
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.
(17 Cases)

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,
Appellant,
vs.
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.
(13 Cases)

THE FARMERS AND MERCHANTS NATIONAL BANK OF LOS ANGELES,
Appellant,
vs.
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.
(15 Cases)

On Appeal from the Supreme Court of the State of California

Motion to Dismiss or Affirm

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Motion to Dismiss or Affirm

Appellee, pursuant to Rule 16 of the Revised Rules of the Supreme Court of the United States, moves the Court to dismiss these appeals or to affirm the judgments of the Supreme Court of the State of California for the following reason:

There is no substantial federal question presented as a basis of jurisdiction in this Court inasmuch as the questions presented have been foreclosed by previous decisions of this Court.

STATUTES INVOLVED

Section 5219 of the Revised Statutes of the United States (12 United States Code, Section 548) and Sections 1, 4a, 23 and 35 of the California Bank and Corporation Franchise Tax Act (Cal. Stats. 1929, Ch. 13, as amended) are set forth in the appendix to Appellants' Jurisdictional Statement. In addition, Sections 2, 3 and 4(1), (2) and (3) of that Act are set forth in the appendix hereto.

STATEMENT

Appellants, national banking associations, appeal from judgments denying recovery in actions for the refund of taxes imposed under the California Bank and Corporation Franchise Tax Act[1] during the years 1933 through 1949.

The present method of taxing national banks in California, carefully drafted to avoid discrimination,[2] was enacted in 1933,[3] and has been in operation throughout the past 28 years. The method is prescribed by Sections 1 and 4a of the Bank and Corporation Franchise Tax Act.[4]

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1. Stats. 1929, ch. 13, p. 19, as amended; Deering's Gen. Laws, 1944, Act 8488. The Act has been codified in the Revenue and Taxation Code as Section 23001, et seq., effective July 1, 1951. These cases relate to a period prior to the codification, and references will be made to sections of the Act rather than to the Code.

2. Traynor and Keesling, Recent Changes in the Bank and Corporation Franchise Tax Act, 21 Calif. L. Rev. 543, 22 Calif. L. Rev. 499, 23 Calif. L. Rev. 51. Traynor, National Bank Taxation in California, 17 Calif. L. Rev. 83, 232, 456.

3. Cal. Stats. 1933, p. 871.

4. The tax imposed on national banks under the Bank and Corporation Franchise Tax Act was "in lieu of all other taxes and licenses, state, county and municipal * * * except taxes upon * * * real property." (Section 3)

From 1933 through 1949, subdivision 3 of Section 4 of the Act imposed a franchise tax at the flat rate of 4 per cent of net income upon every corporation except financial corporations and those exempted by the Constitution or the Act. The corporations taxable under this provision (hereafter referred to as nonfinancial corporations) were required to pay, in addition, other taxes including personal and real property taxes. Banks and other financial institutions[5] were required to pay a tax measured by net income[6] at a rate not to exceed 8 per cent, made up of two parts: (1) A flat rate of 4 per cent, as paid by nonfinancial corporations, and (2) an additional percentage determined on the basis of the ratio between the total California personal property taxes required to be paid by nonfinancial corporations and their total net incomes attributable to California.[7] (Section 4a) This rate was determined annually by the Franchise Tax Commissioner after affording the banks and financial corporations a public hearing and an opportunity to examine the data on which his determination was to be based. (Section 4a)

The Commissioner each year compiled information as to the net incomes and personal property taxes of nonfinancial corporations from their verified franchise tax returns, from audit adjustments dealing with additional assessments and abatements, and from other materials obtained from the corporations. The information was tabulated in statistical form, and transcripts of the returns were made which con-

5. Sections 1, 2 and 4(1) of the Act.

6. Revised Statutes, Section 5219, authorizes state taxation of national banks "according to or measured by their net income."

7. In 1933 and 1934, Section 4a provided that the flat rate, like the one then applicable to nonfinancial corporations, was 2 per cent (rather than 4 per cent) and that the combination of the flat rate and additional percentage should not exceed 6 per cent.

tained the property tax and net income figures with serial numbers instead of names being used to designate the corporations. Two reports containing a proposed tax rate were prepared, one showing an over-all computation and the other a computation by industrial groupings. At the hearings held by the Commissioner the banks were permitted to inspect the transcripts and the statistical material, and members of the Commissioner's staff, having possession of the original returns, answered questions as to their contents so that the lists furnished plaintiffs could be checked for accuracy so far as this could be done without disclosing the names of the corporations.

Additional information and methods of verification were made available to appellants at the trial, specific reference to which will be made in the argument that follows.

Appellants contended they should be allowed unrestricted examination of the tax returns of the nonfinancial corporations despite the provisions of Section 35 of the Act concerning nondisclosure of the amount of income or the business affairs of the corporate taxpayers appearing in their tax returns.[3]

ARGUMENT IN SUPPORT OF MOTION

The Questions Are Not Substantial.

I. IT IS SETTLED BY PRIOR DECISIONS OF THIS COURT THAT THERE HAS BEEN NO VIOLATION OF DUE PROCESS OF LAW.

A. Although the Function of Computing the Bank Tax Rate Was Quasi-Legislative, Information and Hearing Sufficient Even to Satisfy the Requirements of a Quasi-Judicial Proceeding Were Available to Appellants.

This Court in numerous instances has observed that the nature of the function involved is significant when due process concepts are to be considered. In *Hannah v. Larche*,

8. The purpose of the nondisclosure provisions of Section 35 is to facilitate tax enforcement by encouraging taxpayers to make full and truthful declarations in their tax returns.

363 U.S. 420, 440, it was noted that the requirements of due process frequently vary with the type of proceeding involved. What is due process in procedure varies with the governmental purpose to be accomplished and with the nature of the interests affected.

The governmental power here involved is the state taxing power. It is settled law that practical considerations must obtain in tax matters. *Bi-Metallic Investment Co. v. State Board of Equalization*, 239 U.S. 441; *International Harvester Co. v. Evatt*, 329 U.S. 416, 422. The validity of computing a tax rate on the basis of taxes paid by others is well established. *Michigan Central Railroad Co. v. Powers*, 201 U.S. 245. It also has been recognized that complexities may be such that as a matter of practical tax administration "rough approximation rather than precision" is sufficient. *International Harvester Co. v. Evatt*, 329 U.S. 416, 422.

The California statute required the Commissioner to make a statistical survey as to the California net income and California personal property taxes of thousands of non-financial corporations for the purpose of computing a tax rate applicable to a large and indefinite group of taxpayers, including national banks, state banks and all corporations classed as financial corporations,[9] such as savings and loan associations. (Sections 1, 2 and 4)

We are concerned, therefore, with general or legislative facts, not with individual facts—with quasi-legislative action, not with quasi-judicial action. *Bi-Metallic Investment Co. v. State Board of Equalization*, 239 U.S. 441.

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9. Corporations classed as financial corporations are those that are in substantial competition with national banks. *U.S. Loan Service, Inc. v. McColgan*, 21 Cal. 2d 518; *Crown Finance Corp. v. McColgan*, 23 Cal. 2d 280.

The Supreme Court of California referred to the decision of this Court in the *Bi-Metallic Investment Co.* case in pointing to the differences between quasi-legislative and quasi-judicial action. In that case this Court said:

> "Where a rule of conduct applies to more than a few people it is impracticable that every one should have a direct voice in its adoption. The Constitution does not require all public acts to be done in town meeting or an assembly of the whole. General statutes within the state power are passed that affect the person or property of individuals, sometimes to the point of ruin, without giving them a chance to be heard. Their rights are protected in the only way that they can be in a complex society, by their power, immediate or remote, over those who make the rule. If the result in this case had been reached as it might have been by the State's doubling the rate of taxation, no one would suggest that the Fourteenth Amendment was violated unless every person affected had been allowed an opportunity to raise his voice against it before the body entrusted by the state constitution with the power * * *." (page 445)

Appellants in attempting to avoid the impact of the *Bi-Metallic* case,[10] state that in that case the taxpayers had already had, at the local level, the hearing as to comparative valuations to which they were constitutionally entitled under ad valorem procedures. Appellants, however, completely miss the point of the *Bi-Metallic* case. The hearing which the taxpayer had in the *Bi-Metallic* case was as to the valuation of its individual property in relation to the valuation of other property in the county and is comparable to the hearing available to each appellant here as to the amount of its net income. Each bank had the opportunity to explore fully into any adjustment of the net

10. Jurisdictional Statement, page 17, footnote 22.

income of that bank made by the Commissioner. On the other hand, raising the level of valuation of all property in a county, for purposes of a statewide tax, as to which the taxpayer in *Bi-Metallic* sought and was denied a hearing, is comparable to the rate computation here. General facts, rather than individual facts relating to a particular taxpayer, were involved in both the valuation increase order of the *Bi-Metallic* case and the bank tax rate determination of the present cases.

Bi-Metallic establishes that the same due process standards do not apply to general facts as apply to individual facts. *Londoner v. Denver*, 210 U.S. 373, 386, cited by appellants, shows that even when individual facts are concerned, procedural due process standards in tax cases may be far less stringent than those in other cases.[11]

Under these authorities, procedural due process certainly does not require in the determination of a tax rate based on the amount of net income and the amount required to be paid as personal property taxes by several thousand corporations[12] that the banks be permitted to scrutinize and cross-examine in meticulous detail as to every individual corporation as they contend.

The Commissioner's action in making an annual computation of the bank tax rate was characterized as a quasi-

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11. In the *Bi-Metallic* case, this Court observed (page 446) that the property owners in the *Londoner* case "• • • were exceptionally affected, *in each case upon individual grounds* • • • (Emphasis added.) The state statute in *Londoner* denied a landowner the right to object in the courts to the special assessment made against his property. This Court nevertheless indicated that the requirements of due process would have been satisfied if the taxpayer had been accorded the opportunity before the taxing agency "to support his allegations by argument however brief, and, if need be, by proof, however informal." (page 386)

12. As mentioned by appellants, the Commissioner in 1949, for example, had the task of ascertaining the total California net income and total California personal property taxes of 36,000 corporations.

legislative function by the California Supreme Court and appellants recognize,[13] that we are here concerned with a quasi-legislative function. They attempt, nevertheless, to apply standards of due process which are appropriate in quasi-judicial proceedings. Appellants rely on *Ohio Bell Telephone Co. v. Public Utilities Commission*, 301 U.S. 292; *St. Joseph Stockyards Co. v. United States*, 298 U.S. 38; *Morgan v. United States*, 298 U.S. 468; and *Interstate Commerce Com. v. Louisville & Nashville R. Co.*, 227 U.S. 88. These cases relate to the establishment or the validity of rates of public utilities. In public utility matters, affected parties are entitled to a hearing on the question of whether the rates are confiscatory and, also, on whether there is evidence in the record to support the order. As indicated by this Court in *Interstate Commerce Com. v. Louisville & Nashville R. Co.*, 227 U.S. 88, and *Morgan v. United States*, 298 U.S. 468, hearings relating to the confiscatory or non-confiscatory character of public utility rates constitute quasi-judicial action.

The contrast between the establishment of public utility rates on the one hand and tax rates on the other is well illustrated by the *St. Joseph Stockyards Co.* case where the Court pointed out that if the utility rates had been set by the legislature itself, they would have been subject to judicial scrutiny on the issue of confiscation, 298 U.S. 38, 51. On the other hand, it is readily apparent that a state legislature may establish tax rates and that due process does not require that a taxpayer be granted a judicial review of those rates. Cf. *Michigan Central Railroad Co. v. Powers*, 201 U.S. 245, 294-295.

If the Legislature had set the tax rate, appellants would not have any procedural due process right to inquire into how the rate was determined. For example, if the Cali-

13. Jurisdictional Statement, page 15.

fornia Legislature had enacted a flat rate, say of 7%, for a particular year, appellants could question in court whether they were subjected to a higher tax burden than other corporations, but they would have no opportunity to inquire how the 7% rate was arrived at by the Legislature.

Instead of enacting a flat rate, the Legislature provided for an annual computation by the Commissioner under a prescribed formula so that the rate would more nearly follow the fluctuation in the personal property tax burden of nonfinancial corporations. The statute also provided a maximum beyond which the rate could not go. Few indeed are the instances in which as much opportunity has been afforded to taxpayers for obtaining information as to how a tax rate is arrived at as is afforded with respect to the Section 4a tax rate.

It is to be observed that although the Commissioner in computing the bank tax rate was engaged in a quasi-legislative function, the hearing afforded the banks with respect to the tax rates here involved satisfied the requirements of a quasi-judicial proceeding as laid down in the *Ohio Bell Telephone Co.* case, 301 U.S. 292. In discussing that case, the California Supreme Court first pointed out that *Ohio Bell* involved regulation of the rates of a single utility in contrast to the instant case and the *Bi-Metallic* case which involved action applicable to many persons. The Court went on to point out that in the *Ohio Bell* case a rate order was made at the administrative level without knowledge on the part of the utility as to the statistical information and trade journals relied on by the Commission in setting the rates and without any right of judicial review of the rate order. On the other hand, as stated by the California Supreme Court, " * * * In the present cases plaintiffs were informed of the material relied upon by the commissioner

as discussed above, and thereafter they were given opportunities for reasonable verification of that material and for attacking the rates by introducing any relevant, nonprivileged evidence."[14]

Voluminous details as to how the bank tax rate was computed were provided appellants at the bank tax rate hearings,[15] and these details were included in the record of this trial by way of stipulated testimony.[16] Thus, transcripts of bank tax rate hearings extending over some 2,200 pages of the reporter's transcript of the trial in these cases, were placed in the record. In addition, various officials and employees of the appellee were called by appellants and examined as witnesses during the course of the trial. Through these witnesses and the stipulated testimony previously mentioned, appellants were in a position to explore in detail the various steps of the Commissioner's practice in determining the bank tax rate.

With respect to the net income factor, appellee provided appellants with a list utilized by the Commissioner in the bank tax rate computations setting forth for each corporation the serial number of its franchise tax return[17] and the amount of its net income. Appellants had the opportunity to check the returns and other documents, with the serial number but not the name of the corporation disclosed, to ascertain whether the net income figures appearing on such returns and other documents corresponded with those ap-

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14. 55 Adv. Cal. 409, 423; Appendix to Jurisdictional Statement, page 17.

15. Some of the methods of checking made available to the banks at the annual bank tax rate hearings are summarized in *Franchise Tax Board v. Superior Court*, 36 Cal. 2d 538, 542.

16. 11 Rep. Tr. 2896.

17. Serial numbers were stamped on returns consecutively as they were received by the Commissioner.

pearing opposite the same serial number in the list utilized by the Commissioner in the bank tax rate computations.

As mentioned by the California Supreme Court,[18] appellants failed to take advantage of the opportunity afforded them to check against the local property tax rolls the personal property tax figures (of identified corporations) used by the Commissioner. In this regard, appellee offered to make available, with certain minor exceptions, the name of each nonfinancial corporation and the personal property tax figure utilized by the Commissioner for each such corporation.[19] In providing this information, appellee in effect would be saying to appellants: "This is the personal property tax figure used for this corporation in computing the bank tax rate." With such information, appellants could have gone directly to the local property tax rolls, which are public records, to ascertain if the personal property tax figures utilized by the Commissioner corresponded with those shown by the local property tax records. Appellants could have made such an investigation *without resorting to the franchise tax returns of the nonfinancial corporations.*[20] Appellants, however, did not choose to do so, either through the application of acceptable sampling techniques or otherwise. In view of the availability of this and other information herein mentioned, appellants' contention they could not obtain information lacks substance.

In addition to the opportunities for verification previously discussed, numerous other methods of verification

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18. 55 Adv. Cal. 409, 421, Appendix to Jurisdictional Statement, page 12.

19. 23 Rep. Tr. 6200-6203.

20. In *United States v. Reynolds*, 345 U.S. 1, 11, this Court indicated that even where individual rather than legislative facts were involved a litigant who sought disclosure of certain confidential documents should have accepted the Government's offer of information from an alternative nonconfidential source.

were made available to appellants during the trial.[21] The State, throughout the trial, repeatedly offered to provide information to appellants, repeatedly proposed useful and substantial methods of testing the rate computations, and repeatedly offered to comply with any other reasonable and legal methods of verification that might be proposed by appellants.[22]

Reference to the opportunities for checking available to appellants was made by Chief Justice Gibson in speaking for the Supreme Court of California in this case as follows:

> "* * *Much material helpful to plaintiffs in determining the accuracy of the rate was made available to them at both the administrative hearings and the trial, and the only information withheld was such that it would have revealed to them, contrary to section 35, the amount of income or the business activities reported by named nonfinancial corporations. We are satisfied that plaintiffs received all the information they reasonably needed." (55 Adv. Cal. 409, 422, Appendix to Jurisdictional Statement, page 15)

Irrespective of whether appellants were entitled to a hearing as a matter of due process, the fact is that they had a hearing both at the administrative level and at the trial. As the California Supreme Court observed:

> "* * * Plaintiffs in the present cases obtained an independent judicial determination as to the validity of the tax rates after a fair opportunity to present evidence in support of their position. * * *" (55 Adv. Cal. 409, 423, Appendix to Jurisdictional Statement, page 16)

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21. For example, 17 Rep. Tr. 4536-4541, 4569-4571; 19 Rep. Tr. 5244-5245.

22. For example, 20 Rep. Tr. 5503; 21 Rep. Tr. 5677; 23 Rep. Tr. 6235.

Appellants' statement[23] that "The undisputed testimony was that the Commissioner's 'determinations' could not have been verified by any of the methods suggested by appellee" is misleading. The testimony to which appellants refer was given before some of the most significant offers by appellee were made. As pointed out in the opinion of the California Supreme Court, for example, "With respect to the personal property tax data used by the commissioner, an offer was made to provide, with certain exceptions, the names of the corporations together with the amount of tax each had paid. This offer was rejected by plaintiffs * * *."[24] This offer was made and rejected subsequent to the testimony referred to by appellants.

Appellants assert[25] there was no possible way of proving or disproving whether any of the figures included by the Commissioner in his rate computations were those of net income corporations. Contrary to appellants', assertions means were available for verifying that figures utilized by the Commissioner were those of net income corporations. Each tax return filed by a corporation contained the corporate number assigned to that corporation by the Secretary of State. Each tax return also was stamped with a serial number when it was received in the Commissioner's office.

Appellee offered to arrange the net income returns of corporations whose personal property taxes were utilized in the rate computations in corporate number sequence and to allow appellants to see the name and corporate number on each return as well as the affidavit and signature to verify that it was a genuine return. Appellee, upon

23. Jurisdictional Statement, page 18.

24. 55 Adv. Cal. 409, 421, Appendix to Jurisdictional Statement, page 12.

25. Jurisdictional Statement, page 18.

completion of this step, would rearrange the same returns in serial number sequence and allow appellants to check each return (without disclosing the identity of the corporation) to ascertain whether the corporation was a net income corporation. This would enable appellants to ascertain that the corporations whose personal property taxes were included in the rate computation were net income corporations.

Appellants' assertion[26] that the State of California has done everything in its power to prevent any judicial review as to the correctness of the rate computation is not well founded. It is in sharp contrast with the statements of the California Supreme Court that much material helpful to appellants in determining the accuracy of the rate was made available to them at both the administrative hearings and the trial, that appellants received all the information they reasonably needed and that they obtained an independent judicial determination as to the validity of the tax rates after a fair opportunity to present evidence in support of their position.[27]

In view of the information furnished to appellants, the offers to them of additional information and the opportunities available to them for verifying the Commissioner's computations and for presenting evidence, appellants' contentions concerning lack of procedural due process are not meritorious.

Certainly no substantial federal question of procedural due process is presented in view of *Bi-Metallic Investment Co. v. State Board of Equalization*, 239 U.S. 441, and the other precedents of this Court to which we have referred.

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26. Jurisdictional Statement, page 19.

27. 55 Adv. Cal. 409, 422-423, Appendix to Jurisdictional Statement, pages 15-16.

B. This Case Does Not Involve the Imposition of Tax Liability Predicated Upon Incontrovertible Assumptions of Fact.

Appellants' discussion to the effect that tax liability was predicated upon incontrovertible assumptions of fact is without merit. The California statute has been construed by the California Supreme Court as meaning that the amount assessed by the local assessing authorities and paid as personal property taxes is the figure to be used in computing the bank tax rate.[28] Appellants were free to controvert whether the nonfinancial taxpayers had paid the amounts of personal property taxes used by the Commissioner in the rate computation. Appellants contend they were entitled as a matter of due process to inquire into whether the local assessing authorities assessed the correct amount as personal property taxes. A similar argument was rejected by this Court in *Michigan Central Railroad Co. v. Powers*, 201 U.S. 245. This Court there held that the applicable state law construed as providing for a tax rate on railroad property computed on the basis of actual assessed valuations and actual taxes paid on the property of others was valid.

The California Supreme Court agreed that the taxing statute authorized the Commissioner to take the amount of personal property taxes assessed by the local authorities and paid as the amount required to be paid as personal property taxes in computing the bank tax rate. It was then the burden of appellants under Revised Statutes Section 5219 (12 U.S.C. § 548) to show, if such were the fact, that under the state statute as so construed a higher burden was imposed on appellants than the highest burden imposed on mercantile, manufacturing and business corporations. This they failed to do.[29]

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28. 55 Adv. Cal. 409, 423-424, Appendix to Jurisdictional Statement, pages 17-18.

29. The trial court's finding that a higher burden was not imposed is set forth in footnote 36.

II. THE CALIFORNIA TAXING STATUTE CONFORMS WITH REVISED STATUTES, SECTION 5219.

The California bank tax was so designed as to preclude any possibility of a discriminatory tax burden in violation of Revised Statutes, Section 5219.[30] The only restriction imposed by that section on the use of the according to or measured by net income method of national bank taxation is that "* * * the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing, and business corporations doing business within its limits. * * *"

The term "rate" is employed in this restriction in the sense of burden, rather than in the sense of arithmetical rate, (*Tradesmens National Bank v. Oklahoma Tax Commission*, 309 U.S. 560) just as it is in the case of the restriction on the share tax method.[31] *Amoskeag Savings Bank v. Purdy*, 231 U.S. 373; *Covington v. First National Bank*, 198 U.S. 100. The point was well summed-up in the decision this year in *Michigan National Bank v. Michigan*, 365 U.S. 467, 475, as follows:

> "* * * And so, we are taught that in determining the burden of the tax—its discriminatory character—we look to its *effect*, not its *rate*. * * *"

That the California bank tax cannot impose a discriminatory tax burden in violation of Section 5219 may readily be established. State banks were taxed in exactly the same manner as were national banks. The banks, together with

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30. Traynor and Keesling, Recent Changes in the Bank and Corporation Franchise Tax Act, 22 Cal. L. Rev. 499.

31. "In the case of a tax on said shares the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks. * * *" Revised Statutes, Section 5219.

other financial corporations [32] and with nonfinancial corporations, paid a tax measured by net income at a 4% rate.[33] The banks and other financial corporations paid an additional tax measured by net income at a rate based on the ratio of the total amount required to be paid as personal property taxes[34] by the nonfinancial corporations to the total California net income of these corporations.[35]

While the California tax burden on financial corporations may exceed, it cannot be less than, that on banks. As compared with nonfinancial corporations, banks pay a tax measured by net income at a total rate equal to the rate of the franchise tax paid by those corporations plus a rate representing the average burden of the personal property taxes of those corporations in terms of their net income. The only possible conclusion on a comparison of the tax

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32. The term "financial corporation" included all corporations, e.g., savings and loan associations, engaged in substantial competition with national banks. *H.A.S. Loan Service, Inc. v. McColgan*, 21 Cal. 2d 518; *Crown Finance Corp. v. McColgan*, 23 Cal. 2d 280. Such financial corporations pay personal property taxes, but are allowed to offset those taxes against their franchise tax payments, the franchise tax after allowance of the offset not to result, however, in a lesser rate of tax than that applicable with respect to the net income of banks.

33. The rate was 2% for the years 1933 and 1934.

34. The many other taxes imposed by the State and its political subdivisions to which the nonfinancial corporations were subject, but from which the banks were immune, were not considered in arriving at this additional tax.

35. The rate of the additional tax was limited by the taxing statute to 4%. If, therefore, the ratio of the total amount required to be paid as personal property taxes by the nonfinancial corporations to the total California net income of those corporations resulted in a bank tax rate of 2.5%, the banks and financial corporations paid an additional tax according to or measured by their respective net incomes at a 2.5% rate. If, however, that ratio resulted in a rate in excess of 4%, as it did for many years (1933—5.56%; 1934—4.83%; 1935—4.95%; 1936—4.01%; 1937—5.64%; 1938—4.58%; 1939—5.52%; 1940—6.34%; 1941—5.36%), the banks and financial corporations paid an additional tax according to or measured by their respective net incomes at a rate of only 4%. Finding 6, e.g., Sac. No. 6954, Clk. Tr. 55.

burdens of banks and nonfinancial corporations was expressed by the California Supreme Court as follows:

> "* * * The total percentage of net income paid by banks as franchise taxes is equal to the percentage paid by nonfinancial corporations as a group from their combined net incomes as franchise taxes and personal property taxes. Thus, if the banks are required to pay a higher percentage of their net income than some of those corporations, there are necessarily others paying a greater portion of their net income than the banks pay. It is apparent that the tax burden of the banks is not 'higher than the highest of the rates' imposed upon nonfinancial corporations and is in accord with section 5219." (55 Adv. Cal. 409, 417; Appendix to Jurisdictional Statement, page 6)[36]

Appellants do not assert that California imposes upon banks a discriminatory tax burden, but only that California imposes upon banks a discriminatory *franchise tax* burden. A comparison of *franchise tax* burdens is not, however, the test of compliance with Section 5219. As this Court pointed out with great clarity and precision in *Tradesmens National Bank v. Oklahoma Tax Commission*, 309 U.S. 560, 568, the resolution of the issue of discrimination "* * * turns upon an examination of the *whole tax structure of the state.* * * *" (Emphasis added.)

Appellants seek to limit the principle of the *Tradesmens* case by asserting that the true rationale of the case is that where a state reaches the tax-exempt income of national banks under one type of franchise tax, it is competent

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36. The trial court found for each year in question that "the tax burden imposed by the State of California upon plaintiff and other banks for the taxable year was neither higher than the tax burden imposed by the State upon other financial corporations nor higher than the highest of the tax burdens imposed by the State upon mercantile, manufacturing and business corporations doing business within the State of California." Finding 19, e.g., Sac. No. 6952, Clk. Tr. 196.

for it to reach the tax exempts of nonfinancial corporations under another type of franchise tax, provided discrimination against banks is not shown. There is not the slightest degree of support for this position in the opinion of the Court. The references in the opinion to "the whole tax structure of the state" and to "all the taxes imposed upon business and mercantile corporations doing business in the state" and the specific reference to an ad valorem tax establish that the Court regarded a comparison of total tax burdens, not one solely of franchise tax burdens, as the standard for determining compliance of a state tax on national banks with Section 5219.

California has not taxed, either directly or indirectly, the personal property of banks. The amount of tax to be paid by a bank does not depend upon or vary in any way with the amount of personal property owned by the bank.[37]

It is entirely permissible for California to include the interest income of banks from federal securities in the measure of the franchise tax on the banks. *Tradesmens National Bank v. Oklahoma Tax Commission*, 389 U.S. 560, 564. The tax burden imposed on banks not being higher than that imposed on other financial corporations nor higher than the highest imposed on mercantile, manufacturing and business corporations, the fact that banks may hold more tax-exempt securities than other classes of taxpayers offers no basis for objection to the State's method of taxing banks under Section 5219.

37. Traynor and Keesling, Recent Changes in the Bank and Corporation Franchise Tax Act, 22 Cal. L. Rev. 499, 507.

CONCLUSION

Inasmuch as appellants' contentions have been foreclosed by prior decisions of this Court, we respectfully submit that these appeals should be dismissed or in the alternative that the judgments of the Supreme Court of California should be affirmed.

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Appendix

California Bank and Corporation Franchise Tax Act, Section 2.

SECTION 2. TAX ON STATE BANKS. Every bank, other than a national banking association, located within the limits of this State, shall annually pay to the State for the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, upon the basis of its net income for the next preceding fiscal or calendar year at the rate provided for in Section 4a hereof.

California Bank and Corporation Franchise Tax Act, Section 3.

SECTION 3. BANK TAXES IN LIEU OF OTHER TAXES. The tax referred to in Sections 1 and 2 hereof shall be in lieu of all other taxes and licenses, state, county and municipal, upon the banks and banking associations therein mentioned, except taxes upon their real property.

California Bank and Corporation Franchise Tax Act, Section 4.

SECTION 4. TAX ON CORPORATIONS. (1) TAX ON FINANCIAL CORPORATIONS. Every financial corporation doing business within the limits of this State, taxable under the provisions of Section 16 of Article XIII of the Constitution of this State, shall annually pay to the State for the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, upon the basis of its net income for the next preceding fiscal or calendar year at the rate provided for in Section 4a hereof.

(2) FINANCIAL CORPORATIONS; TAX OFFSET. Each such financial corporation shall be entitled to an offset against said franchise tax, in the manner hereinafter provided, in the amount of personal property taxes and license fees for the privilege of operating as personal property brokers, or brokers as defined in Chapter 634, Statutes of 1909, as amended, and those engaged in the business of loaning money, advancing credit, or loaning credit or arranging for the loan of money or advancing of credit or loaning of credit, paid during the income year to this State or to any county, city and county, city, town or other political subdivision of the State, and licenses for the privilege of operating motor vehicles paid to this State under Chapter 362, Statutes of 1935, as amended; provided, however, that the tax on such financial corporation after the allowance of offset shall not be less than 4 percentum of its net income for the preceding fiscal or calendar year or less than twenty-five dollars ($25).

(3) TAX ON OTHER CORPORATIONS. With the exception of financial corporations, every corporation doing business within the limits of this State and not expressly exempted from taxation by the provisions of the Constitution of this State or by this act, shall annually pay to the State, for the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 percentum upon the basis of its net income for the next preceding fiscal or calendar year. In any event, each such corporation shall pay annually to the State, for the said privilege, a minimum tax of twenty-five dollars ($25).

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IN THE

Supreme Court of the United States

OCTOBER TERM 1961

No. 122

SECURITY-FIRST NATIONAL BANK OF LOS ANGELES,
Appellant.

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellee.

(17 Cases)

(Continued on Inside Cover)

On Appeal From the Supreme Court of the State of California.

BRIEF IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM.

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BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Appellee.

(13 Cases)

THE FARMERS AND MERCHANTS NATIONAL BANK OF LOS ANGELES,

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(15 Cases)

On Appeal From the Supreme Court of the State of California.

BRIEF IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM.

Appellee moves to dismiss or affirm upon the ground that the questions presented are not substantial. In so doing, Appellee inadvertently emphasizes the merit in Appellants' case.

I.
Due Process—Secret Evidence.

Appellants, in their Jurisdictional Statement, pointed out that the effect of the judgments below was to uphold the California franchise tax statute, as applied to national banks, upon the basis of evidence which neither Appellants nor the courts below were permitted to see. Appellants' position, briefly stated, was that under the Fourteenth Amendment California can have its secrecy or its tax—but not both. *Ohio Bell Telephone Co. v. Public Utilities Commission,* 301 U. S. 292.

Appellee's approach to this fundamental question may fairly be said to be unresponsive. In an ordinary income tax situation, where one man's tax is nobody else's business, a secrecy provision raises no constitutional difficulties. But here, where the secret information (embodied in a mass of unidentifiable franchise tax returns of non-financial corporations) is utilized to determine the tax liability of a different and unrelated group of taxpayers (the national banks), the state policy of secrecy becomes wholly repugnant to due process guarantees.

A. Appellee's Illusory "Offers".

Appellee seeks to minimize the constitutional problem by emphasizing its various "offers" to disclose information at the trial. The inadequacy of these offers was discussed by Appellants at pages 18-19 of the Jurisdictional Statement. We there pointed out that none of said offers permitted access to the net income or components thereof of identifiable corporations. Without such access the bank taxpayers had no way of verifying or proving whether *any* of the figures utilized in

the rate determinations were or were not properly so utilized, since a given corporation's net income status controlled whether and to what extent, if any, its personal property tax figures should be used in the computations.

By the shuffling process described at pages 13-14 of the Motion to Dismiss, Appellants could indeed have verified that a given group of corporations had reported either net income, net loss or no income or loss. We stress, had *reported*. But the fact in issue was not what they had reported, but *whether what they had reported were the true facts.*[1] And the verity of the facts reported could neither be proven nor disproven so long as access to the only source of verification—the identifiable taxpayer filing the return—was cut off by the secrecy provisions of Section 35.

It is also true that in the last week of the trial Appellee made a belated offer to furnish the personal property tax figures of named corporations utilized in the rate computations. But it is obvious that personal property tax figures were irrelevant without access to the concealed net income status of such corporations. Thus, the offer[2] was refused because it was meaningless, as were all of Appellee's other offers.

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[1]And as pointed out at page 20, Note 24 of the Jurisdictional Statement, not only were the returns suspect from the beginning, but the Commissioner's own recomputations as of December 31, 1951, showed that for every year here involved but one, the net income factor of the Section 4a formula had been understated by many millions of dollars.

[2]Appellee's reference to *United States v. Reynolds*, 345 U.S. 1, in connection with its "offer" is hardly apt. In *Reynolds*, the classified electronic equipment, as to which information was withheld by the government, was not shown to have had any causal connection with the accident complained of. Here, the withheld material constituted the very basis of the rate determinations.

Moreover, and as the record will bear out, the offer in question did nothing to refute our statement, which Appellee has seen fit to characterize as misleading, that the undisputed testimony was that the Commissioner's "determinations" could not have been verified by any of the methods suggested by Appellee. [See testimony of witness Bowles, 22 Rep. Tr. 5914-15; *id.*, 5894-5899.]

It is therefore submitted that Appellee's efforts to evade the consequences, from the due process standpoint, of California's attempt to retain both its secrecy and its tax, are devoid of merit. Appellants were denied the right to examine even *one* identifiable taxpayer's net income and personal property tax data, let alone a representative sample of the full 36,000 returns.

B. Appellee's Attempt to Inhibit Judicial Review.

Unable to demonstrate the adequacy, under the Fourteenth Amendment, of its "offers" of information at the trial, Appellee seeks refuge in a specious distinction between "general" or "legislative facts" as opposed to "individual facts"—between quasi-legislative action as distinguished from quasi-judicial action. These distinctions, with all respect, escape us insofar as they are claimed to negative the right to judicial review of the factual determinations of an administrative taxing agency. *Bi-Metallic Investment Co. v. State Board of Equalization*, 239 U. S. 441, is of no aid to Appellee in our setting: that case involved only an unwarranted attempt to *enjoin* action by the taxing agency. No one here contends that the Commissioner could have been enjoined from fixing the rate; but this does not mean that his acts are judicially untouchable on review. So also, in *Bi-Metallic* no factual determinations were in-

volved; the State Board simply raised already established valuations under state constitutional powers.

Appellee's hidden thesis is that in any case of quasi-legislative action, there is no right to a judicial review of the facts and evidence upon which the agency acted. This proposition is belied by the Court's decision in *Ohio Valley v. Ben Avon Borough,* 253 U. S. 287,[3] where both the majority and the dissenting opinions agreed on the necessity for some type of judicial scrutiny of the evidence underlying a quasi-legislative determination. It is also opposed to the distinction noted in *Norwegian Nitrogen Co. v. United States,* 288 U. S. 294, 317-318, between those quasi-legislative bodies which (as there) merely advise and those which (as here) ordain. "Whatever the appropriate label, the kind of order that emerges from a hearing before a body with power to ordain is one that impinges upon legal rights in a very different way from the report of a commission which merely investigates and advises." 288 U. S. at p. 318.

The true principle is as laid down in *Londoner v. Denver,* 210 U. S. 373, where the court said:

> "But where the legislature of a State, instead of fixing the tax itself, commits to some subordinate body the duty of determining whether, in what amount, and upon whom it shall be levied, and of making its assessment and apportionment, due process of law requires that at some stage of the proceedings before the tax becomes irrevocably fixed, the taxpayer shall have an opportunity to be heard. . . ." (210 U. S. at pp. 385-386.)

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[3]Referred to at page 17, Note 23 of the Jurisdictional Statement.

II.

Due Process—Incontrovertible Assumptions.

Appellants, in their Jurisdictional Statement, noted a further *constitutional* flaw in the franchise tax statute —that, as applied, it sanctions the imposition of a tax upon assumptions of fact which Appellants were forbidden to controvert. Jurisdictional Statement, pp. 21-22. And this despite undisputed evidence of widespread misclassification by California assessing authorities in levying on non-financial corporations the personal property taxes which were the foundation for the assumptions. *Ibid.*

Appellee completely misconceives the import of this argument. It has nothing to do with Revised Statutes Section 5219, but rather with the elementary right of a taxpayer under the Fourteenth Amendment to challenge demonstrably incorrect assumptions of fact. *E.g., Heiner v. Donnan,* 285 U. S. 913. This issue was in no way involved in *Michigan Central Railroad Company v. Powers,* 201 U. S. 245, which is cited by Appellee as dispositive. The point we make is simply that California cannot predicate its tax upon assumptions of fact which the taxpayer is forbidden to controvert.

III.

R. S. 5219.

Appellants, in their Jurisdictional Statement, stressed a third defect in the California statute, namely, that it unlawfully discriminates against national banks in violation of R. S. 5219 by providing for taxation of their franchises at a rate and burden up to twice that imposed on the franchises of non-financial corporations.

Basically, Appellee's position on this question is that R. S. 5219 permits California to double its tax on the

franchises of these federal instrumentalities in order "to make up for their exemption [under that very statute] from personal property tax." Jurisdictional Statement, p. 26. Appellee thus attributes to Congress a bizarre intention to grant the exemption, on the one hand, only to take it away on the other.

The fundamental vice in Appellee's position, in a word, is that it wholly disregards the intention of Congress to *bar*, not to sanction, the discrimination that California openly practices. This is made clear by the Congressional discussions which led to the 1926 amendment of R. S. 5219.[4] The House Report on that measure—the basis upon which it went to the Senate and thence to Presidential approval—made it abundantly clear that irrespective of what method the states employed in taxing their own corporations, the burden of the tax on the banks was not to be higher than the burden imposed upon other corporations generally *under such excise or franchise tax.* We quote from the report:

> "The language of the pending bill is broad enough to permit a state that imposes corporate excise or franchise taxes which are not based on income to apply the net income method to national banking associations, provided the burden of tax is no higher than that imposed upon other corporations generally *under such excise or franchise tax."*[5] [House Report No. 526, Sixty-ninth Congress, First Session; 67 Cong., Rec., Pt. 6, p. 5762; 16 Rep. Tr. 4196.]

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[4]See Appendix to Jurisdictional Statement, pages 42-45.

[5]Emphasis supplied.

When California applied, under R. S. 5219, the fourth method of taxation to national banks, it elected to tax non-financial corporations by the *very same method*[6] as that applied to banks. The subject and the measure of California's franchise tax are hence identical for both banks and other corporations. Only the rates of tax are different, in palpable discrimination against the banks.

Appellee's reliance on the share tax cases to justify the discrimination is inapt. Experience with share tax comparisons early showed that while arithmetical "rates" might be identical, in lip service to R. S. 5219, valuation methods might be varied substantially, to the detriment of the bank shareholders. *Pelton v. National Bank,* 101 U. S. 143. Owners of other moneyed capital might be given deductions or exemptions that were not available to bank shareholders. *Evansville Bank v. Britton,* 105 U. S. 322; *Boyer v. Boyer,* 113 U. S. 689. Or important elements might be omitted in assessing other moneyed corporations, which were included in assessing national bank shares. *San Francisco National Bank v. Dodge,* 197 U. S. 70.

The ingenuity of the states in attempting to evade R. S. 5219 thus led the Court to the adoption of a policy of broad construction of the word "rate" to pre-

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[6]In the *Tradesmens National Bank* Case, 309 U.S. 560, Oklahoma did not tax non-financial corporations by the same method as that applied to national banks. Hence the need, in that case, for a comparison of relative burdens.

vent open discrimination in the overall assessment. *Cf. People v. Weaver,* 100 U. S. 539, 545. But, where a taxing state selects the *same method* of reaching the *same taxable subject* (as permitted by R. S. 5219) in the case of both national banks and its other taxpayers (of the appropriate class prescribed in R. S. 5219), *rate* and *burden* are synonymous. And in such a situation, unlike that in *Tradesmens National Bank v. Oklahoma Tax Commission,* 309 U. S. 560, there is no need for conducting an examination of "the whole tax structure of the state."[7]

In the instant case, all other elements going to make up the tax—except for the rate—are equal;[8] hence there is neither occasion nor reason to justify open discrimination *in the rate* itself. Where, as here, the subject and method of taxation are the same but the rate is different, *both the fact and the extent of the unfriendly discrimination appear on the face of the statute itself. Cf. Merchants National Bank v. Richmond,* 256 U. S. 635.

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[7]The passing reference in *Tradesmens* to the fact that Oklahoma also imposed an ad valorem tax generally upon moneyed capital—traditionally capital in competition with national banks—does not aid California's position here. Such a tax might properly be considered as negating, in Oklahoma's case, the intent to discriminate against national banks which is apparent on the face of the California statute.

[8]Which was not the case in *Michigan National Bank v. Michigan,* 365 U.S. 467. See Jurisdictional Statement, p. 26, N. 29.

Conclusion.

For the foregoing reasons, and for the reasons set forth in the Jurisdictional Statement, it is submitted that the questions presented by these appeals are substantiated and of public importance; and that probable jurisdiction should be noted.

Respectively submitted,

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